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NOMINATIONS OF JOHN R. DAHL, GEORGE J. BENSTON, DERRYL J. McLAREN, GORDON C. SOUTHERN, AND EDWARD C. WILLIAMSON, JR.

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

THE NOMINATIONS OF JOHN R. DAHL, OF NORTH DAKOTA, GEORGE J. BENSTON, OF NEW YORK/GEORGIA, DERRYL J. McLAREN, OF IOWA, GORDON C. SOUTHERN, OF MISSOURI, AND EDWARD C. WILLIAMSON, JR., OF GEORGIA, TO BE MEMBERS OF THE BOARD OF DIRECTORS OF THE FEDERAL AGRICULTURAL MORTGAGE CORPORATION

SEPTEMBER 13, 1988

Printed for the use of the
Committee on Agriculture, Nutrition, and Forestry

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CONTENTS

Page

Hearing held on: September 13, 1988 1

NOMINATIONS OF JOHN R. DAHL, GEORGE J. BENSTON, DERRYL J. McLAREN, GORDON C. SOUTHERN, AND EDWARD C. WILLIAMSON, JR.

Leahy, Hon. Patrick J., a U.S. Senator from Vermont, opening statement 1
Prepared statement 4
Lugar, Hon. Richard G., a U.S. Senator from Indiana 1
Conrad, Hon. Kent, a U.S. Senator from North Dakota 3
Harkin, Hon. Tom, a U.S. Senator from Iowa 28
Prepared statement 5
Boschwitz, Hon. Rudy, a U.S. Senator from Minnesota, prepared statement 6
Bond, Hon. Christopher S. "Kit", a U.S. Senator from Missouri, prepared statement 7
Karnes, Hon. David K., a U.S. Senator from Nebraska 17
Prepared statement 8
Emerson, Hon. Bill, a Representative in Congress from the Eighth Congressional District, State of Missouri, prepared statement 11
Fowler, Hon. Wyche, Jr., a U.S. Senator from Georgia 28

CHRONOLOGICAL LIST OF WITNESSES

Dahl, John R., of Gackle, ND, nominated to be a Member of the Board of Directors of the Federal Agricultural Mortgage Corporation 12
Benston, George J., of New York, NY, and Atlanta, GA, nominated to be a Member of the Board of Directors of the Federal Agricultural Mortgage Corporation 20
Williamson, Edward C., Jr., of Camilla, GA, Derryl J. McLaren, of Farragut, IA, and Gordon C. Southern, of Steele, MO, nominated to be Members of the Board of Directors of the Federal Agricultural Mortgage Corporation 28
Grassley, Hon. Charles E., a U.S. Senator from Iowa 29

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Dahl, John R:
Prepared statement 39
Biographical Information (Public) 42
Financial Data and Conflict of Interest (Public) 43
Responses to questions from Senator Thomas A. Daschle 44
Responses to questions from Senator Tom Harkin 46
Benston, George J.:
Biographical Information (Public) 49
Financial Data and Conflict of Interest (Public) 52
Letter of, dated August 1, 1988, to Ms. Christine Sarcone, Chief Clerk, answer to a portion of question 6 53
Published writings:
"Charges of Redlining Have Little Foundation in Fact," Forum, "the Atlanta Journal," Sunday, June 19, 1988 54
"Federal Regulation of Banking: Analysis and Policy Recommendations," "JBR, Journal of Bank Research," Winter 1983—republished in updated form in Fall 1987 under title: "Why Continue to Regulate Banks: An Historical Assessment of Federal Banking Regulation," "Midland Corporate Financial Journal" 55
"Do We Really Need the SEC?", April 1986 "CFO Magazine" 84

Page

Benston, George J.—Continued
Responses to questions submitted by Senator Patrick Leahy 86
Responses to questions submitted by Senator Tom Harkin 88
Responses to questions submitted by Senator Thomas A. Daschle 91
Williamson, Edward Charles, Jr.:
Biographical Information (Public) 94
Answers to Biographical Information—questions numbered 4, 5, 6, and 7 .. 96
Financial Data and Conflict of Interest (Public) 97
Answers to Financial Data and Conflict of Interest Questions 98
Additional Information—Biographical Information and Financial Data and Conflict of Interest 99
Responses to questions submitted by Senator Thomas A. Daschle 100
Responses to questions submitted by Senator Tom Harkin 102
McLaren, Derryl Jay:
Biographical Information (Public) 104
Financial Data and Conflict of Interest (Public) 107
Responses to questions submitted by Senator Tom Harkin 109
Responses to questions submitted by Senator Thomas A. Daschle 111
Southern, Gordon Clyde:
Biographical Information (Public) 113
Financial Data and Conflict of Interest (Public) 116
Unpublished writings and speechs: Enclosure No. 1:
Statement—Belle Fountain Project, public meeting held by U.S. Corps of Engineers on March 31, 1981, at Caruthersville, Missouri ... 118
USDA 1982 Wheat Program Provisions, February 13, 1982 122
Remarks to the Mississippi River Commission: High-water inspection trip, Caruthersville, Missouri, May 17, 1982 123
Remarks made to the Resources Conservation and Development Commission, annual meeting at Dexter, Missouri, April 1985 124
Remarks made to the Pemiscot County Farm Bureau, annual meeting, at Hayti, Missouri, August 22, 1985 128
Remarks to the Missouri Senate Interim Committee at the National Guard Armory in Dexter, Missouri, October 29, 1985 131
Remarks to the American Soybean Association Board of Directors, January 1986 133
Background—Soybean Proposal 135
Enclosure No. 2: Farm Credit System Loan Activity 136
Responses to questions submitted by Senator Tom Harkin 137
Responses to questions submitted by Senator Thomas A. Daschle 140
Sears, Earl W., executive vice president, National Cotton Council of America, letter of, dated August 8, 1988, to Hon. Patrick Leahy 142
Humphrey, Dale, president, National Cattlemen's Association, letter dated July 11, 1988, to Hon. Patrick Leahy 143

NOMINATIONS OF JOHN R. DAHL, GEORGE J. BENSTON, DERRYL J. McLAREN, GORDON C. SOUTHERN, AND EDWARD C. WILLIAMSON, JR.

TUESDAY, SEPTEMBER 13, 1988

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 9:45 a.m., in room SR-322, Russell Senate Office Building, the Hon. Patrick J. Leahy (chairman of the committee) presiding.

Present or submitting a statement: Senators Leahy, Boren, Harkin, Conrad, Fowler, Daschle, Lugar, Cochran, Boschwitz, Bond, and Karnes.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

The CHAIRMAN. If the committee will come to order, we will hold the confirmation hearing on those who have been nominated to be members of the Board of Directors of the Federal Agricultural Mortgage Corporation. They include John R. Dahl of North Dakota, George J. Benston of New York and Georgia, Edward C. Williamson, Jr., of Georgia, Derryl J. McLaren of Iowa, and Gordon C. Southern of Missouri.

I know that Senator Conrad of this committee is here to introduce Jack Dahl who many of us know anyway. I am glad to have both of them here, but before I yield to Senator Conrad, I yield to the distinguished Senator from Indiana.

STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM INDIANA

Senator LUGAR. Well, good morning, Mr. Chairman, and honored guests. I am particularly pleased to be here today for this hearing to consider the nominations of the five Presidential appointees to serve on the Permanent Board of Directors of the Federal Agricultural Mortgage Corporation.

The significance of this meeting is that it is actually taking place at this time. Significant progress has been made toward implementation of the secondary market for agricultural mortgage loans in the last few months since the program has been enacted. When I think back over the months of debate and diverse views and positions that were advocated by the many interested groups all during

the development of the 1987 Farm Credit Act, there were many times when it was difficult to imagine that we would be here today for this purpose.

But we are, and I want to note that the enormous progress made in the implementation of the secondary market is due in large measure to the dedicated efforts of the Interim Board members and the industries involved. I know that we will shortly hear from the Chairman of the Interim Board, Mr. Jack Dahl, who will give a status report on the action the group has taken and the prospects for the sale of at least $20 million worth of stock in Farmer Mac, possibly as soon as early November.

Since Mr. Dahl will be covering this subject, there is no need for me to recite what I know about these accomplishments other than to say that I am most impressed with the cooperation that is evident among the various industry groups involved in the project. I am convinced that the expeditious implementation of the secondary market for agricultural mortgage loans will infuse into the agricultural credit field a healthy dose of competition that is sure to bring about benefits to farmers across this land.

Let me comment for just a minute on the importance of confirming the nominees that we will hear from before the end of the 100th Congress. The Permanent Board of Farmer Mac Corporation is made up of 15 members, 5 of which must be confirmed by the Senate. The Chairman of that Board is selected from among the 5 subject to Senate confirmation.

Mr. Dahl, who has received very high marks as Chairman of the Interim Board, has been designated to serve as Chairman of that Board by the President. It is obvious then that without successfully completing this confirmation process, the 10 elected members of the Permanent Board could not practicably form into an operating unit and conduct the business of the Corporation. This would cause significant delay in the implementation process until new nominations could be submitted by the next President of the United States and acted upon by the Senate. I would venture to guess that would not be before next spring at the earliest.

The momentum that has developed would surely be lost. The potential for early development of this new credit mechanism for American farmers would be gone. There is reason to believe that if these nominations are not confirmed, the planned sale of stock in the Corporation might even have to be delayed to avoid the possibility that the stock issuance would fail to attract sufficient investors to meet the target level of $20 million that must be reached for the Permanent Board to be formed.

In view of this, I am committed to working with Chairman Leahy and the leadership of the Senate to see that the nominations before this committee are promptly considered and brought before the Senate for action. For this process to be successful, it is clear we must have strong bipartisan support and there must be absolutely no question about the qualifications of each of the nominees and no controversy over their fitness for those positions.

I am looking forward to hearing from each of the nominees as the hearing process proceeds and expect prompt action by the committee on them in the next few days.

Mr. Chairman, I thank you, as always, for providing me this opportunity to address the committee and to welcome these nominees.

The CHAIRMAN. Thank you very much, Senator Lugar. I agree. I am delighted that Mr. Dahl is here and I will be interested in seeing how the initial stock offering is apt to go. I think this whole program was a major part of the legislation we passed last year and I think, Mr. Dahl, you know that Senator Lugar and I are committed to the oversight process to make sure that the Board works.

With that, I would yield to Senator Conrad for an introduction.

STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator CONRAD. Thank you, Mr. Chairman, I appreciate that. I notice that we have on our list this morning John R. Dahl and, of course, we all think of him as Jack.

The CHAIRMAN. I had to look twice. I couldn't figure who this John Dahl was when I first saw the list.

Senator CONRAD. I did too, because in North Dakota everyone knows Jack Dahl, one of the most prominent citizens of our State. He is the Chairman of the Interim Board and is the immediate past president of the National Cattlemen's Association, former president of the North Dakota Stockmen's Association, a winner of one of the most prestigious honors in North Dakota, the North Dakota "Man of the Year in Agriculture" award, and Jack is also holder of the North Dakota National Leadership Award of Excellence. He is someone of whom our State is very proud.

We especially salute the service that he has given the country as Chairman of the Interim Board, and we want to give him a special welcome here this morning. Mr. Chairman, I know we will treat him with the deference and respect that we treat everyone that comes before this committee. I want to present Jack Dahl, someone who, as I have said, is one of the most respected citizens of the State of North Dakota. Jack Dahl.

The CHAIRMAN. Thank you very much.

Senator HARKIN. Mr. Chairman, I have a statement for the record.

The CHAIRMAN. Without objection. Also, we will hold the record open for a day for anyone who has opening statements to be put in.

Go ahead, Mr. Dahl.

[The prepared statements of Senators Leahy, Harkin, Boschwitz, Bond, Karnes, and Representative Bill Emerson from Missouri follow:]

Statement of the Honorable Patrick J. Leahy, Chairman,
Committee on Agriculture, Nutrition, and Forestry

Hearing on the Nominations to the Board of the
Federal Agricultural Mortgage Corporation
September 13, 1988

This morning, we will hear from five nominees to the permanent Board of the Federal Agricultural Mortgage Corporation. The "Farmer Mac" will be responsible for setting up a secondary market in farm real estate loans similar to the "Ginnie Mae" program for home mortgages. The new permanent Board will play a pivotal role in getting the secondary market off the ground.

This secondary market was a principal feature of the Agricultural Credit Act of 1987, and I am committed to seeing it implemented.

The need to provide adequate credit to ensure economic growth in rural America has been a central issue throughout American history. From the days of the Jacksonian Revolution, rural Americans have understood that without credit, economic growth in rural America will be stifled.

The Congress created Farmer Mac to ensure that adequate credit at fair rates will continue to be available to rural America.

We are fortunate to have among our nominee-witnesses three members of the current interim Farmer Mac Board, including the Chairman, Mr. Dahl. They will be able to update us on the board's progress to date. I understand that substantial progress has been made in laying the groundwork for the Corporation's initial $20 million stock offering and we will be interested to hear more about this from our witnesses.

We will start with Mr. Dahl. Then we will hear from Mr. Benston, Mr. Williamson, Mr. McLaren, and Mr. Southern.

STATEMENT OF SENATOR TOM HARKIN

Hearing on Nominations to the Board of Directors
of the Federal Agricultural Mortgage Corporation

September 13, 1988

Mr. Chairman, I welcome the opportunity that this hearing on nominations to the Board of Directors of the Federal Agricultural Mortgage Corporation provides to bring the operation of a secondary market in agricultural mortgage loans a bit closer to reality. The provisions of the Agricultural Credit Act of 1987 creating Farmer Mac indeed constitute landmark legislation holding the promise of securing much-needed capital for our farmers, ranchers and rural communities.

This Committee's work on drought legislation over the summer has provided compelling evidence that increased levels of credit will be essential to help farmers and ranchers keep their land, remain in business and recover from the drought's devastation. After showing some improvement, land prices have already begun to edge downward again in response to the drought--a clear sign that finances are once again getting tight for our agricultural producers.

Putting Farmer Mac into operation and ensuring that it fulfills its intended mission will not be an easy task. All of us, and members of the Board in particular, must work together to create a good solid system that will inspire the confidence of investors and that will, by providing a readily available secondary market for rural real estate loans, help a wide range of our family farmers, ranchers and rural communities meet their credit needs. Because of the importance of the Board's work, I attach great significance to these nominations and approach them with much interest.

STATEMENT BY SENATOR RUDY BOSCHWITZ

SENATE AGRICULTURE COMMITTEE

SEPTEMBER 13, 1988

I commend the Chairman for calling this hearing today to consider the nominations of five individuals to be members of the Federal Agricultural Mortgage Corporation Board.

Early this year legislation establishing the Federal Agricultural Mortgage Corporation (the so-called Farmer Mac) was signed into law by President Reagan. Along with several other members of this Committee, I spent a great deal of time last year working on the farm credit legislation which created Farmer Mac.

By creating Farmer Mac, we were looking toward the future to ensure that there will be a variety of credit sources available to rural America. A strong agricultural sector needs access to credit at reasonable and competitive rates, and a secondary market can play a key role in providing that credit. A secondary market offers another source of credit for farmers, allows local banks to reduce their risk in providing long-term, fixed-rate mortgages, and enhances competition among agricultural lenders.

I am impressed with the progress that already has been made in getting Farmer Mac off the ground and running. The Committee now should act quickly on these nominations, so that the full Senate can vote on these nominations before the session concludes. It is vital that no delay occur between the operations of the interim and permanent boards that govern Farmer Mac. Once in place, the permanent board has an important role in setting the underwriting standards for loans and certifying the eligible poolers for the secondary market.

Again, Mr. Chairman, I am pleased that the Agriculture Committee is considering these nominations today.

STATEMENT BY SENATOR CHRISTOPHER S. BOND (R-MO.)
BEFORE THE SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
TUESDAY, SEPTEMBER 13, 1988, 9:30 A.M.

Mr. Chairman, this morning marks yet another important step in the implementation of the Farm Credit Act of 1987. As you are aware, the Federal Agricultural Mortgage Corporation will play a vital role in ensuring the availability and long-term viability of agricultural credit. I commend Senators Leahy and Lugar for acting upon these nominations in such an expeditious manner and hope they can be cleared for Senate confirmation in the very near future.

Although absent by necessity, I am very pleased that a fellow Missourian, Mr. Gordon Clyde Southern, has been nominated to be a member of the first Board of Directors of the Federal Agricultural Mortgage Corporation. To quote Mr. Southern, he is "American by birth, Missourian by choice and a Southern by the grace of God." I am proud to support Mr. Southern's nomination and feel his wealth of experience will be an asset to the Corporation.

Throughout 1987, Congress wrestled with the problems facing the ailing Farm Credit System. After countless briefings, meetings and hearings, a comprehensive bill was developed. While it addressed many problems facing agricultural lending institutions, this legislation formalized the concept of a secondary market for agricultural mortgages. I support this concept and feel that the competition derived from the sale of pooled mortgages will have a definite multiplier effect--from agricultural lenders and farmers to rural communities and ultimately consumers.

Mr. Chairman, while I regret that I am not in attendance to introduce my friend Mr. Southern, please be assured of my support for his nomination.

David K. Karnes

HEARING ON FARMER MAC NOMINATIONS

A STATEMENT BY SENATOR DAVID K. KARNES

BEFORE THE SENATE AGRICULTURE COMMITTEE

SEPTEMBER 13, 1988

First of all, I want to thank the Committee Chairman and ranking Minority member for moving quickly to complete the appointments to the permanent board of directors of the Federal Agricultural Mortgage Corporation (Farmer Mac). Farmer Mac is the newly created corporation that will guaranty pools of farm mortgages that will back securities to be sold by agricultural lenders. The five nominees before the committee are public appointees to the 15 member board. The other board members represent commercial banks, insurance companies, and Farm Credit System institutions.

It is in the interest of our farmers and ranchers to get these Farmer Mac board members confirmed and seated before congress adjourns. The sooner Farmer Mac is up and running, the sooner the long-term, fixed rate credit that farmers need will be out there. That credit will be offered at very competitive rates and can really help farmers cover their borrowing costs over time.

Farmer Mac was created as part of the 1987 Farm Credit System bail-out legislation. The establishment of a secondary market in farm real estate mortgages has been one of my top priorities. I took a leading role both as a member of the Senate Agriculture committee but also as a conferee in the Senate - House conference in fashioning that part of the law because of its importance.

Farmer Mac has been on a relatively fast track so far, lets continue to move it forward expeditiously. The common stock of the new corporation will soon be offered for sale to financial institutions that make and pool farm mortgage loans. At the same time, loan underwriting, appraisal, and servicing standards are being developed. The Corporation is operating under an interim board appointed by President Reagan until the permanent board is in place.

As a farm owner myself, I know how input costs impact operators, and one of the biggest costs to operators is debt service. Farmer Mac can do for Nebraska's farmers and ranchers what a secondary market in residential loans has done for our nation's homeowners. And farmers will also be able to get a fixed rate loan and have other investors share the interest rate risks.

I have had the advantage of knowing something about mortgage lending. I see Farmer Mac as a unique chance to reshape farm lending for the betterment of producers and to prepare the agricultural credit system for the 21st century.

I find it heartening that several of these five board nominees are farmers. Farmer Mac is a case study in how farmers and lenders can get together for their common good. The board will require that commercial banks, insurance companies, FCS institutions, and farmers cooperate and work together to make the new secondary market a success. I am confident this will happen. I urge my colleagues on the Agriculture Committee and in the Senate to give Farmer Mac their full support and to act favorably on these nominations quickly.

STATEMENT OF THE HONORABLE BILL EMERSON
TO THE SENATE AGRICULTURE COMMITTEE
REGARDING THE NOMINATION OF MR. CLYDE SOUTHERN
TUESDAY, SEPTEMBER 13, 1988

I want to thank the Senate Agriculture Committee for allowing me to submit some brief remarks regarding one of my good friends from the "Bootheel" of Missouri, Mr. Clyde Southern, who has been nominated to assume one of the posts on the newly created "Farmer Mac" Board. It is with great pleasure that I enthusiastically endorse Clyde's nomination and request that his appointment be expeditiously confirmed by the Senate.

Clyde Southern has been a wise counsel to me over the years on matters relating not only to agriculture, but also to the broader interests of southeast Missouri. I trust his judgment, and the Board can, too, as it embarks on its mission to deliver competitively-priced credit to America's farmers.

As an experienced farm owner and operator, Clyde Southern has an intimate working knowledge of agriculture and the Farm Credit System which will enable him to make a valuable contribution to the Board. Clyde has also repeatedly demonstrated his leadership skills as a Colonel in the U.S. Army Reserves and through his involvement in numerous local and state civic organizations. This experience will be a valuable asset as Farmer Mac gets started.

I trust this Committee will approve Mr. Southern's appointment without dissent. He's competent, honest, and a leader in every sense. He'll make an excellent addition to the Board.

STATEMENT OF JOHN R. DAHL, OF GACKLE, ND, NOMINATED TO BE A MEMBER OF THE BOARD OF DIRECTORS OF THE FEDERAL AGRICULTURAL MORTGAGE CORPORATION

Mr. DAHL. Thank you, Mr. Chairman, and Senator Conrad. I am not sure that—you embarrass me a little bit this morning, but it is nice to be embarrassed once in a while.

Mr. Chairman and members of the committee, I am very, very pleased not only to be here today but pleased that you are having these hearings, and as Senator Lugar in his comments, and you, Mr. Chairman, said, it is important that we keep the momentum going, and especially in light of the drought situation. I think that the secondary mortgage market for agriculture is not only one of the most important aspects of the legislation you folks accomplished last year, but also, I think we will be able to help cushion the blows of the drought if we proceed on a timetable that we have been on since May of this year.

I do have a statement to read, with your permission, Mr. Chairman, that briefly backgrounds the committee on what we have done to this point. It may also open the door for some questions later and I would be very happy to do my best with that.

The CHAIRMAN. Go ahead.

Mr. DAHL. As you know from my introduction, I am the Chairman of the Interim Board of Directors of the Federal Agricultural Mortgage Corporation, more commonly known as Farmer Mac. Incidentally, I never have liked acronyms. I tried to think of a better one than Farmer Mac because every time I think of Farmer Mac I think of bib overalls and I do not think that is the impression we want to leave. But I could not come up with one, but we will keep working on it. Nine of us were appointed by President Reagan and were sworn in by Secretary of Agriculture Lyng on June 16, 1988. Since that time, we have been actively meeting and aggressively moving toward the issuance of the initial stock offering in a minimum amount of $20 million, and the establishment of Farmer Mac's operations.

The Interim Board of Directors has, since its first meeting, operated with the spirit of full cooperation from all segments represented. I would just like to reemphasize "spirit of full cooperation" because it has been tremendous, and that is really the reason we have made the, I think, outstanding progress to this point that we have. Discussions have been open and penetrating. We have moved deliberately. Among other decisions, the Interim Board opted to employ no paid staff members prior to the stock offering, thus leaving that responsibility to the Permanent Board. The services of three consultants have been retained: Mr. James Murray of Brown & Wood as legal consultant; Mr. Chairman, I would like to introduce those folks with your permission. Jim Murray, would you stand please. Jim has been very, very able legal counsel to the Interim Board; Mr. Henry Edelman of PaineWebber of New York City, our financial consultant—Henry—and C.W. Bill McMillan of McMillan & Farrell Associates as coordinating consultant and also he has been appointed by the Board to serve as the Secretary. Bill. Thank you, gentlemen.

Since there was no start-up money provided, Farmer Mac has signed a commercial bank borrowing agreement in the amount of $500,000 in order to get the Corporation up and running. After an extensive selection process, the Board on August 26 chose the First Boston Corporation to be the lead underwriter in the initial stock issuance. If all goes as planned, the Offering Circular will be issued in early October, thus setting the stage for the sale of the class A and class B voting common stock.

There still are some policy decisions that have to be made before this stock offering is consummated, because purchasers will be both investors in and users of Farmer Mac. The criteria for eligibility to be a pooler or an originator must be set prior to the stock offering; the minimum stock purchase must be set for each category; and there will need to be preliminary determinations for standards for appraisal, credit underwriting and loan documentation. Each of these needs to be addressed in disclosures in the Offering Circular.

The Interim Board is limited by the Agricultural Credit Act on certain policy decisions, such as standards for appraisal and credit underwriting. However, certain tentative determinations must be made as recommendations for approval by the Permanent Board. For example, the statue requires the Permanent Board to establish appraisal and credit underwriting standards within 120 days after the Permanent Board is seated. The Interim Board is and has been very conscious that the decisions it makes now are only of a temporary nature and will be in the form of recommendations to the Permanent Board. To ensure a successful stock offering and compliance with relevant securities laws, we need to take some of these steps while recognizing that the statue creating Farmer Mac delegates the first decisions to the Permanent Board.

It is timely and necessary to have the public members confirmed by the Senate before the conclusion of the 100th Congress. As you can see from my comments, the Interim Board has placed Farmer Mac on a fast track with momentum and anticipation from all parties involved—the borrowers, the originators, and the poolers, et cetera. We are confident that the initial stock offering will be concluded expeditiously and without any major problems if all parties continue to move as they have so far.

The Permanent Board could take over full responsibility for running of Farmer Mac as early as January of 1989 if all goes well. Having the public members confirmed and the early election of board members from holders of class A and class B voting common stock can provide an expanded opportunity to meet the financing needs of agricultural producers and rural housing needs.

Mr. Chairman, thank you again for having these hearings. My colleagues currently serving on the Interim Board who are here today, may wish to make additional comments or observations later on.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Dahl, and I am glad you introduced the three people you have hired to help get the program off the ground.

Let me just ask the basic questions we ask of all nominees.

If your nomination is approved by the committee and the Senate, do you promise to respond to requests to appear and testify before

this committee or any other duly constituted committee of the Senate?

Mr. DAHL. Yes, sir.

The CHAIRMAN. If you are confirmed by the Senate, will you faithfully execute the laws passed by Congress regardless of any prior statements you have made or biases you may hold?

Mr. DAHL. Yes, sir.

The CHAIRMAN. Now, the Interim Board adopted a bylaw on conflict of interest as article III, section 9, under which the Board can disqualify any director from voting or being counted toward a quorum on any issue where he had a conflict of interest.

How would this provision apply to public directors like yourselves who are farmers or ranchers who plan to continue their farming business even though they will be on the Board?

Mr. DAHL. Well, it would be hard for me to see where there really could be a conflict of interest, but if there were one and it were identified as such, I think the same regulations and bylaws would apply to public as well as other members of the Board.

The CHAIRMAN. Well, let me try to give more of a specific example. Would you agree that you would have to disqualify yourself from any Board action or deliberation affecting any bank or financial institution with which you do business on your own personal basis?

Mr. DAHL. Yes, I would.

The CHAIRMAN. And that would apply to everybody else on the Board.

Now, you discuss in your statement some of the steps the Interim Board has taken to prepare for floating the required initial $20 million Farmer Mac stock offering.

Excuse me. When I come back to Washington, I find that there is a little bit more in the air here than there is back home. I have to recall one time when I had a friend from Washington up to visit me on my farm in Vermont and we are looking down the valley. It was a gorgeous clear day. In front of my house, you look down this long valley to mountains about 25 or 30 miles away. It was so clear you could almost reach out and touch them.

I said, isn't this a beautiful view? He says, nope. I said, what's wrong with it? He says, I come from Washington and I don't trust air that you can't see. [Laughter.]

What is your best guess timetable for the issuance of this stock and the election of Board members?

Mr. DAHL. Well, we are looking right now at completing the stock sale by early November and I think from that point we will go immediately into developing the necessary process of the election procedures.

The CHAIRMAN. How about the commercial banks and the farm credit institutions? Are they showing an interest in buying the stock? What kind of feelers are you getting?

Mr. DAHL. It has really amazed me the tremendous interest that is out there and the perception of all present agricultural lenders that I am aware of and those that may be new players and the enthusiasm they have for this program. So I think all of the Board would concur with me that we really do not foresee any problem in the stock issue. I think it will go very well.

The CHAIRMAN. Suppose you get oversubscribed, with this kind of interest. Suppose you get good valid offers for—well, I will just pick a figure—$50 million instead of $20 million. As I recall the law, there is no ceiling on what you might come out with. Would you be inclined to go more than the $20 million?

Mr. DAHL. Well, really, the Board has not made that decision yet, so it would be presumptuous of me to say that.

The CHAIRMAN. But the Board would have the legal authority to do that if they felt a necessity for it; am I correct?

Mr. DAHL. Yes, sir.

The CHAIRMAN. Now, as I understand it, the Interim Board has appointed committees to consider underwriting standards and appraisal standards and the other rules of Farmer Mac. The final adoption of these rules is the province of the Permanent Board with review by the Congress, and not the Interim Board. And the reason, I understand, is that the prospectus for the initial stock offering has to discuss these issues for proper disclosure to potential investors.

This is kind of an anomalous situation. I wonder how you are handling having to set interim policies on these issues without tying the hands of the Permanent Board to change them later on.

Mr. DAHL. Well, that is somewhat difficult because the statute I do not think is extremely clear on this matter. But in order to have a stock issue and have some confidence in the purchasers of the stock, we need to develop some of these standards. I think those purchasers will need to be very aware, and we will make them aware, that these will simply be recommendations to the Permanent Board for final adoption.

The CHAIRMAN. On the Interim Board, you have private financial institutions, Farm Credit System banks, and farm producers. How are these groups working together?

Mr. DAHL. Beautifully.

The CHAIRMAN. Do they talk to each other? I do not say that facetiously because this Board was set up with these different groups to try to get as much expertise as we could.

Mr. DAHL. Believe me, I am not saying that facetiously. Acting as Chairman, I had anticipated some problems along these lines because there were controversies during the legislative process, as you well know. And I have been very pleasantly surprised at the total cooperation and the total effort made by each Board member to make this think work.

The CHAIRMAN. I am pleased to hear that. You know, we had to go through all kinds of give and take here to put this Board together. I think everybody was hoping that they would then work together and you could get a broad scale expertise. We are talking about a complicated enough area where no one segment has all the answers. In fact, had we tried to draw things to aim just for one segment of the farm community, we would have guaranteed failure right there. There are just too many groups involved. So I am delighted to hear that.

Senator Lugar.

Senator LUGAR. Mr. Chairman, during the development of this legislation there was considerable anxiety about what the effect of Farmer Mac would be on the Farm Credit System itself. I know

you have given a great deal of thought, as have the other Interim Board members, to this, and from your experience thus far as you have thought through how this is to be formulated, what sort of instructions or recommendations would you make to the Permanent Board? Also, how would you assess the impact on the Farm Credit System this year and as you see it next year?

Mr. DAHL. Well, I can only really speak, Senator, from my own observation on this, but I see a tremendous turnaround by members of the Farm Credit System who really opposed very strongly the creation of the secondary market. I believe that they have said to themselves or to their peers, we have it now, it will help our System; it may hurt a bit in the beginning but long term this will be good for the Farm Credit System as well as all of agriculture.

That is the general feeling that I have gotten.

Senator LUGAR. So their comments to you have been supportive as opposed to the other?

Mr. DAHL. Yes, sir, very much so.

Senator LUGAR. Have you had any comments from members of the administration with regard to your activities or to the idea of Farmer Mac? As you recall, there was some reticence on the part of the administration to back this concept in the bill.

Mr. DAHL. I have personally had none.

Senator LUGAR. Has it been total support, as far as you can tell, from the administration as you have proceeded?

Mr. DAHL. Yes, sir.

Senator LUGAR. Thank you.

The CHAIRMAN. Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

If I might, Jack, I am interested in the thinking that has gone into the first issuance, the size and the other parameters that guided the issuance of the first $20 million. And, what are the factors that would enter into, in your judgment, a decision on future issuances and the size thereof?

Mr. DAHL. Senator, I do not believe I can answer these questions at this point. We have, as I said in my opening statement, First Boston Corporation to be the lead underwriter and none of these things have been really decided by the Board to this point.

We will be having a meeting this week, Friday, here in town to discuss the very questions you have asked me, so I am really afraid I cannot answer those at this point.

Senator CONRAD. Mr. Chairman, if I might, the size of the first issuance, that has been determined, has it not?

Mr. DAHL. No, it has not.

Senator CONRAD. That still is open to decision?

Mr. DAHL. Yes, sir.

Senator CONRAD. What would be your own personal views on what the factors are? I am not asking for a conclusion, but what are the factors to consider in determining the size of the first issuance?

Mr. DAHL. Well, it seems to me that it was the wisdom of Congress that $20 million was probably adequate, but I think we have to be aware that there is a perception by a lot of people of what we do, or what we may not do, and I think that is one of the questions that the Board has to ask itself this week; what will be the percep-

tion? We know there is a tremendous amount of interest if we go beyond the $20 million. But I think the perception aspect of it will be important.

Senator CONRAD. Has there been any preliminary recommendations made by your financial advisers as to the potential demand? That is, have the advisers that you have hired come to the Board and said, for example, we see a demand in the first issuance for $50 million or some other figure?

Mr. DAHL. No hard figure has been presented to us other than we feel quite confident that there will be good demand.

Senator CONRAD. Has their advice been that they sense there is strong demand in the marketplace for an initial offering?

Mr. DAHL. Yes.

Senator CONRAD. Have there been any indications from your financial advisers as to any cost/benefit analysis? That is, based on the size of the initial offering, that it needs to be at a certain level in order to provide the greatest efficiency and the greatest return?

Mr. DAHL. I am not real sure Senator if I understand that question to give you a good answer.

Senator CONRAD. Let me flesh it out a little by saying I would assume that you do not want to go to the market with too small an offering, that the cost of making an offering would argue for a certain size. Have there been judgments made as to the cost effectiveness of various sizes of the initial offering?

Mr. DAHL. Well, we have asked a number of investment banking firms to present proposals to the Board and during the selection process we did, of course, select First Boston. There were a number of those types of figures kicked around but the Board itself has seen those but we have not reached any decision at this point.

Senator CONRAD. All right. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Karnes.

STATEMENT OF HON. DAVID K. KARNES, A U.S. SENATOR FROM NEBRASKA

Senator KARNES. Thank you, Mr. Chairman, and welcome, Jack.

Mr. DAHL. Thank you.

Senator KARNES. I have a statement I would like to have submitted for the record, Mr. Chairman.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Karnes can be found on pages 8–10.]

Senator KARNES. I have the advantage of knowing something about mortgage lending, having been in a Federal agency organization myself as Chairman of the Federal Home Loan Bank of Topeka, and I see Farmer Mac as a unique chance to reshape farm lending for the betterment of producers and to prepare agriculture credit for a very prosperous 21st century. I find it heartening that several of these five Board nominees are farmers. I think that is critically important. We have discussed that during the hearings.

Farmer Mac, in my estimation, is a case study of how farmers and lenders can get together for their common good. The Board will require, of course, commercial banks, insurance companies, the

Farm Credit System and farmers cooperating and working together, and your leadership, I have heard from other sources, has been very impressive to date in having those people work together. It is that North Dakota "can-do" attitude in part, I am sure.

I am confident that this will be a very successful enterprise and one that the Government will play a very important role in making sure that we can take full advantage of the innovation that we find in the marketplace.

Now, as a farmowner myself, I know how important the one aspect of this is, and that is making credit affordable and available, and that was the benchmark, I believe, as we went through our deliberations.

Do you have any sense at this point in time about the positive impact on interest rates that this might have? Has First Boston given you any indication as to what they may see or maybe some of your Board members speculate as to the positive impact on interest rates that may be available for our farm and ranch borrowers?

Mr. DAHL. Well, Senator, farm and ranch borrowers, as you know, need some interest rate relief, and the sooner the better. I think the secondary mortgage market will probably do more than all of the other legislation that you folks accomplished to do that. It will increase the competition out there and maybe we will see more smiles when we are greeted at the bank doors than we have in the last few years.

This is only a guess, but some figures I have heard is from a half a point to a point reduction, but that is not going to happen overnight. It will take a while and, unfortunately, a lot of my compadres will no longer be with us by the time we really do some good.

Senator KARNES. What is your timeframe? Assuming that the sale will take place in November of this year, when do you think that we will have a system that borrowers in Nebraska, North Dakota, Vermont, Indiana, and Iowa can see as available to them?

Mr. DAHL. Well, this is pure conjecture but I would hope by mid-1989 that we will be moving and doing some good.

Senator KARNES. Again, this may be a bit presumptuous or premature, but I know the expertise that First Boston brings to these types of agency offerings and agency markets. Is it the understanding that there will be much more standardization of loan documents and have you—maybe this is more for the Permanent Board than your Board—but a standardization process whereby the paperwork itself will be consistent throughout the country and that will provide again, as it has in the residential mortgage markets, a real opportunity for true pooling? Have there been any discussions at your level on standardization of documents?

Mr. DAHL. Yes, there have been. In fact, we have a task force—in fact, four task forces—working at the present time and meeting to develop those types of standards and standard formats and so on. They have not completed their work as yet so I really cannot give you a definite answer.

Here, again, the Interim Board has been in a bit of a quandary, but in order to develop the proper circular for the stock issue we have to give the potential buyers something to go on. So we may be

a little bit out of our field, but it is kind of a damned if you do and damned if you don't situation, so we are going it.

Senator KARNES. What are the other task forces that you have, Jack?

Mr. DAHL. I would ask—since I have not got that on the tip of my tongue—Henry Edelman.

Mr. EDELMAN. We have four task forces operating right now. The first is on credit underwriting standards; the second is on appraisal standards; the third is on loan documentation standards; and the fourth is on eligibility criteria for poolers and originators.

Senator KARNES. Mr. Chairman, I just want to again congratulate Jack and the members. I am just so anxious to get this off and going and I have a great deal of confidence that the farmers and ranchers who are looking to see this make more credit available and affordable will find that under the leadership of this group and the Permanent Board and I am just pleased that we can move quickly on this and keep the momentum going.

Thank you.

Senator BOREN [presiding]. Thank you, Senator Karnes. Senator Leahy will be back in just a moment.

I also want to welcome Jack this morning and say how pleased I am to have him serving on the temporary board and that he has been appointed to the Permanent Board. He has certainly been a great help to us as we fashioned the farm credit legislation. We have benefited from his advice as we were talking about creating the secondary market. We have benefited from his advice and expertise on many other agricultural issues in the past and I was very pleased by the appointment and welcome you today.

Senator Harkin, any questions that you might have?

Senator HARKIN. I have no questions.

Senator BOREN. Any other question? Senator Cochran.

Senator COCHRAN. Mr. Chairman, thank you. I just wanted to ask the witness if you see any impediment to prompt implementation of the legislation that we passed? I know that regulations have been submitted to the Congress and there is a 30-day comment period available.

Do you know of any impediment to going forward and seeing the legislation implemented—and particularly the secondary market aspects—implemented in a timely way?

Mr. DAHL. No, sir, at least not at this point. Again, we are very appreciative, and I personally am, of this committee having this hearing today. I saw that as a potential impediment. We have got a tremendous amount of momentum going here and the feeling is great. The feeling is good. And if we can have an orderly transition from the Interim Board to the Permanent Board, which looks like we will have, we can keep that momentum going and the quicker we can get totally operational, the more we can do for agriculture.

Senator COCHRAN. Thank you.

Senator BOREN. Thank you very much.

[The biographical information of Mr. Dahl can be found at the end of the hearing.]

Senator BOREN. I will ask Mr. George Benston to come forward now. Mr. Benston, if you have any opening remarks that you would

like to present to the committee, we would be very happy to receive them at this time.

STATEMENT OF GEORGE J. BENSTON, OF NEW YORK, NY, AND ATLANTA, GA, NOMINATED TO BE A MEMBER OF THE BOARD OF DIRECTORS OF THE FEDERAL AGRICULTURAL MORTGAGE CORPORATION

Mr. BENSTON. Thank you, sir. I do not have any prepared remarks, except to say that I agree totally with what Jack said. We worked very, very well together. I think we are well on our way to actually implementing the legislation. I find it personally very exciting to be in on the ground floor of what I think will be a very considerable advance in benefit to the farm community and to the taxpayer, because I think this will fly. It will work. There is a lot of work to be done, but it is work that can be done and it is worth doing.

I would be pleased to answer any questions that you may care to ask me.

The CHAIRMAN. Thank you. Let me ask the basic question that is asked of all nominees. If your nomination is approved by the committee and the Senate, do you promise to respond to requests to appear and testify before this committee or any other duly constituted committee of the Senate?

Mr. BENSTON. Yes, I do.

The CHAIRMAN. And if you are confirmed by the Senate, will you faithfully execute the laws passed by Congress regardless of any prior statement you have made or biases you may have held?

Mr. BENSTON. Yes, I do.

The CHAIRMAN. Now, your role as an appointed Farmer Mac director would be to represent the general public in counter balance to banking and Farm Credit System interests represented by the Board's 10 elected members, along the lines of what Mr. Dahl and I discussed earlier of the balancing of interests.

The 1987 statute specifically mandated this balance by requiring that the five appointed directors could not be or ever have been officers or directors of a financial institution.

I understand, Professor Benston, that you have worked extensively with the bank and savings and loan industries over the years. Last year, you received a large consulting fee from a major California bank. Your significant research on proposed 1985 rules by the Federal Home Loan Bank Board regarding direct investment by savings and loan organizations was itself financed by a major savings and loan.

Now, in your submission to the committee you said that you plan to continue your consulting business during your tenure on the Farmer Mac Board. So the question is—and I give that only as background—is this: Do you envision that you will continue to accept consulting work for pay from banks and financial institutions who may be eligible or want to become Farmer Mac poolers or originators while serving on the Board?

Mr. BENSTON. I would like to make one thing clear, Senator. I wanted to be as careful as I could to disclose everything about myself to the committee.

The CHAIRMAN. I appreciate that.

Mr. BENSTON. I have actually not done this work for banks or savings and loans associations or for the industry. These were research projects that they supported but in no way directed and in no way told me what to do or how to do it.

What I expect to continue to do is to continue to do research and writing. I actually do not do consulting for these organizations. But should there ever be——

The CHAIRMAN. But they pay for it.

Mr. BENSTON. They pay for the research, just as, for example, my research has been paid for by the National Science Foundation, by the State of New York Banking Department, and others who asked me to do a study that I feel I have competence in doing.

Should there ever be a situation in which any one I had contact with in the past or might even have contact in a financial way in the future be in conflict with any decision I have to make on the Board, I will either recuse myself or I certainly will disclose it to the Board.

The CHAIRMAN. So, are you saying that you would still accept consulting work from banks or financial institutions, or that you feel that you should be open to accept consulting work from banks and financial institutions?

Mr. BENSTON. Well, in fact, I have never done consulting work for banks or financial institutions that would be related to what Farmer Mac is doing. Should there be something that is in conflict with anything that Farmer Mac is doing, I would not accept it.

The CHAIRMAN. That is not the question. You can have banks and financial institutions who want to become Farmer Mac poolers or originators. Do you see any problem in doing consulting work for them? Lets even say that the consulting work does not involve Farmer Mac, it involves something different, but the XYZ bank wants to be a Farmer Mac pooler or originator. Do you see any problem in them hiring you to be a consultant for them or to do consulting work for them of some nature, unspecified?

Mr. BENSTON. I think if there were any possible conflict that I would not accept the work.

The CHAIRMAN. Well, you do not see any conflict at all in this bank coming before the Farmer Mac asking to be a pooler or originator and hiring you as a consultant, irrespective of the subject of the consulting work?

Mr. BENSTON. I am sorry, sir. What I am saying is that I would not accept an assignment from a bank that might come before Farmer Mac.

The CHAIRMAN. In your answer, that wasn't clear, at least not to me. I thought you were talking about what the subject might be and not about whether that they were offering to hire you as a consultant, period.

Mr. BENSTON. Let me give you an example, sir, of something I did about a year ago. The Bank of America asked me to address a training group in operations about control. Now, I gather Bank of America might be involved with Farmer Mac as a pooler and originator. At this point, I would just not have anything to do with them rather than take the chance that somebody might think that

any decision I might make on Farmer Mac would be inconsistent with my responsibilities.

So even though I do not see any relationship between the two, I would opt on the side of not chancing the possibility that it might be misunderstood and therefore would not accept it.

The CHAIRMAN. Well, I think that it could well be misunderstood. I can give you an example. Again, bank XYZ hires you to give a management training seminar. I do not know if you do that or not, but I just give that as an example. And then they are in competition with bank ABC before the Farmer Mac, and XYZ wins out, maybe totally on the merits. If ABC is disgruntled over their winning out, you can just imagine the comments that will be made.

Mr. BENSTON. Yes. I think that is very valid. I understand, and I would turn down any possibilities that might at any stretch of the imagination be considered to be a conflict.

The CHAIRMAN. The easy case is, obviously, the one where somebody calls you up and says, I want you to consult with us on how to apply to become a Farmer Mac originator. I mean, that is the easy case. It is the appearance cases that are the more difficult.

If the committee were to ask you as a condition of your appointment to agree to stop performing consultant work for pay for any bank or financial institution eligible to participate in the program as a pooler or originator during the period of your service on the Board, how would you respond to that?

Mr. BENSTON. I would not have any problem with that. I am not doing it at the moment and if the committee felt that that would be proper, then I would agree to it. I do not intend to do it in any event.

The CHAIRMAN. You have written extensively on your regulatory philosophy toward banking and financial issues. The regulations the Permanent Board is going to set up—underwriting standards and the pooler eligibility standards and so on—are going to set the tone for the secondary market. They will be vital in establishing its credibility in the financial community.

Let me ask you a couple of questions about your regulatory beliefs. In one article, "Do We Really Need the SEC?"—published in CFO Review in April 1986—you argue that corporate disclosure rules administered by the SEC are not cost effective and should be repealed and replaced by a largely voluntary system.

I just want to make sure that that is still your view, that SEC corporate disclosure rules should be largely repealed and replaced by a voluntary system.

Mr. BENSTON. Yes. This is not a matter of philosophy with me, Senator; it is a matter of research. And the research that I have done and that others have done that I am familiar with indicates just that, and that is the conclusion I drew. I have no reason to feel that the research is inaccurate. Should there be evidence of the contrary I would, of course, change my conclusions.

The CHAIRMAN. The reason I ask this question is that the Farmer Mac statute contains a number of customer protections, including disclosure by banks to farm borrowers on loan pooling. Also, Farmer Mac securities and broker dealers, some of them, have to register with the SEC and that subjects them to the SEC disclosure rules.

Do your views toward SEC disclosure have any bearing on your feeling toward these provisions of the Farmer Mac program?

Mr. BENSTON. Not at all. I believe the disclosures are proper and for any corporation, private or Farmer Mac. As a director, I would be in favor of that disclosure, whether it was required by law or not.

The CHAIRMAN. Again, in another article, "Why Continue to Regulate Banks: An Historical Assessment of Federal Banking Regulation," you argue that most traditional reasons for regulating banks are obsolete and most Federal regulation should be abolished.

Does that reflect your current thinking?

Mr. BENSTON. As long as we qualify properly the word "most." I am not saying all at all, but most, I would say yes, it does.

The CHAIRMAN. Well, do you believe that the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Home Loan Bank Board should be cut back and that most government restrictions on market entry for banks should be removed?

Mr. BENSTON. Certainly the restrictions on entry should be removed. And by cutting back, what I was referring to there is that there is a very important regulatory role to be played in supervision and monitoring of banks. I think we have gotten into a lot of trouble by not doing that effectively and I thought it could be done more effectively by an agency that was dedicated to supervision and monitoring rather than one that had a variety of charges.

The CHAIRMAN. Do you believe that the current $100,000 insurance on accounts by the Federal Deposit Insurance Corporation should be cut back or eliminated, particularly for time-dated deposits such as CD's?

Mr. BENSTON. Yes. One of the problems we have had with banks is that depositors have not cared whether the bank was run properly or not because the Government would step in and bail them out, as has occurred.

What I was referring to there was that I would like depositors to have a concern about the way the banks are being operated. I do not believe deposit insurance either can be or should be eliminated at all. What I was referring to there were things like certificates of deposit, where there is no possibility of runs. What we were seeing at that time, and still are seeing, is the large scale brokering of such CD's which allowed some savings and loans to acquire enormous amounts of money which then they put out at great risk and at cost to other banks and eventually to the taxpayer.

The CHAIRMAN. How do you see your views as affecting the regulation of the Farmer Mac programs? I am thinking particularly of eligibility standards for poolers and originators, underwriting standards for pooled loans. Would you have a laissez-faire attitude? A tough attitude? How would you feel?

I am not asking you to write the regulations here at the table, but to give me your general attitude.

Mr. BENSTON. Well, I think first we want to have as many people competing with each other to offer the farmer and rancher as much opportunity to make loans as possible. We do not want to cut out smaller banks. Anybody who wants to offer his or her services to the farmer should have that right and the farmer should have as many opportunities to borrow as possible.

That, I gather, is one of the major parts of the legislation. That is important.

The only concern is that one does not want to have people involved who might defraud the system, who might not have their own capital involved so that if something should go wrong, they cannot meet their obligations.

Farmer Mac should be organized so that the $1½ billion in Treasury funds that we could call on are never called on.

The CHAIRMAN. Are never called on?

Mr. BENSTON. They are there as a back stop, and it is very important, but I think our job is to make sure that the thing is structured so that in fact we never have to call upon the Treasury, that the system works by itself. If we set up the proper appraisal standards and pooling standards, I think that can be done and will be done.

The CHAIRMAN. But to protect that $1½ billion you also have to have fairly tough standards and protection devices for the activities of Farmer Mac directly and initially, do you not?

Mr. BENSTON. Absolutely.

The CHAIRMAN. Professor Benston, I have gone way over my amount of time. I will have a number of questions which I will submit for the record and we will get those out to you very, very quickly, and I will yield to Senator Lugar.

Senator LUGAR. Thank you very much, Mr. CHAIRMAN. I would like unanimous consent for a statement by Senator Boschwitz to be made a part of our record.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Boschwitz can be found on page 6.]

Senator LUGAR. I have been asked to announce that Senators Bond and Danforth and Congressman Emerson are in Missouri today and thus are not present, as they would like to be, to introduce the nominee, Mr. Southern.

The CHAIRMAN. I might note that a number of Senators have been in and out of here today. There has been a great deal of interest in this hearing. A couple of Senators have been unable to make it but they have contacted us. I think that there has been more interest in this Board than we normally see when we have Assistant Secretaries of Agriculture coming up for review. I think everybody wants the program to work. We all realize we are going into somewhat uncharted seas here, but we do want it to work.

Senator LUGAR. I share your perception, Mr. Chairman. It is gratifying to see the attendance on both sides of the aisle.

Mr. Benston, your academic record is extraordinarily impressive and I suspect, even though this has not been recited for the benefit of all who are attending the hearing today, that you have been involved in many, many academic pursuits now over the course of almost three decades.

Let me just ask for some examples of the nature of the research that you have been doing. The Chairman has asked questions about bank-supported consultation which you have defined appropriately as in fact research projects.

What sorts of subjects do banks employ you to look into? Can you describe that research?

Mr. BENSTON. Yes. I would be very pleased to. The one that the Chairman referred to on savings and loans actually was a research study on the reasons that the savings and loan industry was in the trouble that it was; what were the causes? And in particular, were they related to the direct investments or the growth or interest rate controls, or a variety of other things.

In doing that, I had total freedom and was not only not directed, but I never asked and was never told how to do it or what to do. And indeed, the paper that finally resulted was published by the series published by New York University and was outside referred by two independent referees, academic referees who do not know the author, usually, and who have no alliance other than that it should be good academic work.

Another study that I did that people have mentioned is on mortgage red-lining and, in fact, that was financed by the New York State Banking Department and by the National Science Foundation. And basically, again, it was straight research about a question. They proposed the question and after that I did what I felt was the proper intellectual way to deal with the question.

I once did a study on overdraft banking. Again, a bank paid for the resources to do the study but that was all and in some ways the president did not like it. In fact, I might even say, sometimes the people when you do these studies do not like them. I keep to myself, as I think all academics do, the absolute right of publication. That is, I will never accept resources to do a study when the person for whom I am doing it can control whether it gets published or not, because then it is—I am an academic and my job and my responsibility to the university is to do independent research, not directed research and not contract research in the sense that somebody says, we want you to find such and such.

If anybody said that to me I would say, you are looking for somebody else, you do not want me.

Senator LUGAR. In short, you believe you have been scrupulous in following the high standards of the academic code that you have just articulated in each of these situations of publication? You have remained independent in your judgment and likewise, as in the case of some publications, have had outside referees who determined the quality of the work and its appropriateness for publication?

Mr. BENSTON. Yes. In fact, I say all of them have.

Senator LUGAR. In all cases?

Mr. BENSTON. Yes, in all case.

Senator LUGAR. Let me simply ask you why you are interested in serving on this Board? You, obviously, are a person who is well occupied in your professorship and in all of the research in which you are involved. Why is this calling of interest to you?

Mr. BENSTON. Well, for several reasons. It certainly is not monetary. And the major reasons are that, one, it is personal in the sense that I thought I could learn from the experience and it will help me be a better teacher and a better researcher, and I have.

The second thing is, I thought that I might have something to contribute and it is sometimes a little hard to say this because it sounds so self-serving, but I think I can be helpful. I think having looked over the legislation I am very much in sympathy with it. I

think that this is exactly the kind of blend of Government and private industry that can be very meaningful and very successful, that we can do something very helpful for the farm community in the United States, and I think for the U.S. citizens, because if we are successful in what we do, and I think we will be, the cost to the taxpayer will be lower and the benefits of the farmer will be higher.

We can do something good here and I guess I would like to do good.

Senator LUGAR. Please let me ask you to be as self-serving as necessary in answering this question. Has the research that you have completed—and you have written tens of papers, as are indicated in the vitae here—has this research made you a better judge of the standards that Farmer Mac must have in order that there will be safety for the Federal Government and all the taxpayers of the country as well as those to whom stock is to be sold? And if so, in what ways would the research that you have done lead you to be a better judge of these financial criteria and thus bring greater safety to all the parties in this?

Mr. BENSTON. Well, one think I have done a lot of reading in, in order to do my teaching, is in mortgage, backed securities and in the market of securitized assets. I think I know a little bit about it at this point and that I can bring some of that knowledge to be helpful to my colleagues who know a lot more about farms than I do, and that is a benefit.

What I have done in the research is to show what happens when controls were not effective, when controls were not on lending. For example, I had occasion to study the Continental Illinois failure and the Penn Square disaster. I hope that never happens again, and I think it need not happen if we establish the kind of controls that are necessary.

One, it is not beneficial to the borrowers because sometimes people are encouraged to take out money that they cannot repay. That ruins their lives as well as has a negative effect, first on Farmer Mac and then on the taxpayer. So I think what I have learned in my research and what I have to do for my teaching will be helpful in setting this up so that it will be effective.

Senator LUGAR. Mr. Chairman, I raised the last question simply because I suspect that during the course of the sale of the stock, the getting underway of Farmer Mac, we are likely to be visited, as Members of the Senate, with all sorts of other banking disasters in other areas and this is why the integrity and the confidence with which this is pursued is of the essence. The background chatter is likely to be very, very considerable and with a great deal of undermining on the part of many people in the public of what sort of authorities have been doing what and why people were asleep at the switch.

In this case, it is imperative. You understand that and this is the reason for my curiosity as to who on this Board really has studied, as you say, Penn Square or Continental or any of the numerous disasters that litter the horizon right now, so that this is not replicated in farm credit at a time that there are enough problems in agricultural America without adding those to them.

Mr. BENSTON. I think the often-quoted statement of the philosopher Santayana—"Those who do not study history are doomed to relive it"—I think I can bring to this Board a lot of years of studying that history so that we can benefit from the good parts and not repeat the bad parts.

Senator LUGAR. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Fowler.

Senator FOWLER. Mr. Chairman, I may have some questions for the record. I know of Mr. Benston's fine reputation at Emory University. We even met one time in 1965 when I was with Congressman Charles Weltner and you were working with the House Banking and Currency Committee, the days of both our misspent youth.

The CHAIRMAN. Those days are over?

Senator FOWLER. I am just assuming they are over for Professor Benston. He has gone on to his reward.

Mr. BENSTON. Emory is a fine reward to go on to.

Senator FOWLER. I am very pleased to have Professor Benston here today.

Mr. BENSTON. Thank you, sir.

The CHAIRMAN. Senator Karnes.

Senator KARNES. Professor Benston, I know I have had a chance to read a number of your papers in the past, particularly in the savings and loan industry. There are two words that we are going to be hearing a lot about next year. We have already heard a lot about them this year, particularly in my capacity as a member of the Senate Banking Committee, and that is safety and soundness of institutions.

I believe the comments of my colleague from Indiana are very well taken in that if we want to preserve in this institution, this agency, the safety and soundness that we all desire in some of the other Federal agencies, that the perspective that you bring and the history that you can recite will be very valuable to the entire formulation of this very important lending source for our farmers and ranchers.

I would like to say that I appreciate your willingness to participate in this endeavor. I think it will be very beneficial and the perspective that you bring is very important, so I appreciate that very much.

Mr. BENSTON. Thank you very much.

The CHAIRMAN. Senator Daschle.

Senator DASCHLE. I have no questions, Mr. Chairman.

The CHAIRMAN. Thank you. Well, then, Professor Benston, I have no further questions. As I said, I will submit some questions for the record. We will get those to you just as quickly as possible.

Mr. BENSTON. Thank you. I will be very pleased to answer them.

The CHAIRMAN. Thank you very much.

[The biographical information of Mr. Benston can be found at the end of the hearing.]

The CHAIRMAN. I was thinking, because of the time constraints, that I would ask Mr. Williamson, Mr. McLaren and Mr. Southern if they could come up here as a panel, the three of them. I know that Senator Fowler wishes to introduce Mr. Williamson, and I know that Senator Harkin and Senator Grassley are here to introduce Mr. McLaren. Senator Lugar has already noted that the Sena-

tors from Missouri are required to be in Missouri this morning, or else they would be here to welcome Mr. Southern.

Their statements will be made a part of the record.

[The prepared statements of Senator Bond and Congressman Emerson can be found on pages 7 and 11.]

STATEMENTS OF EDWARD C. WILLIAMSON, JR., OF CAMILLA, GA, DERRYL J. McLAREN, OF FARRAGUT IA, AND GORDON C. SOUTHERN, OF STEELE, MO, NOMINATED TO BE MEMBERS OF THE BOARD OF DIRECTORS OF THE FEDERAL AGRICULTURAL MORTGAGE CORPORATION

The CHAIRMAN. Gentleman, if you would sit down, and Senator Fowler, I would yield to you for the introduction of Mr. Williamson.

STATEMENT OF HON. WYCHE FOWLER, JR., A U.S. SENATOR FROM GEORGIA

Senator FOWLER. I appreciate that, Mr. Chairman. Just briefly, I have known Mr. Williamson, here on my right, for several years and I am very pleased to have this opportunity to introduce him to the committee. He has been an active contributor to all phases of the rural economy as well as distinguished himself on the local level in various degrees of leadership.

He is a graduate of Auburn University. He served in the U.S. Army Reserve. He has had many years of experience running a small business and a family farm. He is familiar—far more familiar than I—with a broad spectrum of agriculture, including our famous peanuts, pecans, soybeans and corn. He even claims some expertise, I think, in pine trees.

He has testified before the Congress before, Mr. Chairman, about the pecan industry and he does have agricultural credit experience from serving on the Board of the Farmers Home Administration in Mitchell County.

I think that Mr. Williamson is a man of demonstrated experience and concern, which certainly qualifies him, as we deal with these thorny issues concerning the needs of our small towns and small businessmen and farmers.

I know the committee will give very close attention to his qualifications and give him, I hope, favorable consideration with the other nominees that we have this morning.

The CHAIRMAN. In fact, if Mr. Williamson wants to tell us anything about you, Senator Fowler, he is welcome to do that, too.

Senator FOWLER. Yeah, let's hear it all. [Laughter.]

He has been coached in his testimony. He will demur at this time.

The CHAIRMAN. Before we go to Mr. Williamson, I want to recognize Senator Harkin and Senator Grassley for purposes of introducing Mr. McLaren.

Senator Harkin.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA

Senator HARKIN. Mr. Chairman, thank you.

I am pleased to introduce Derryl McLaren, a fellow Iowan, as one of the nominees to the Board of Directors of the Federal Agricultural Mortgage Corporation. Derryl lives in Fremont County in southwest Iowa near the town of Farragut with his wife Carma and two sons, Jay and Jarrett. Along with his father and brother, he is involved in a family farming operation consisting of livestock, corn, and soybeans.

Derryl is a graduate of Iowa State University, the foremost agricultural university in the entire universe, where he received a Bachelor's Degree in agricultural business and completed a year in graduate study in economics before returning home to farm.

Derryl has been active in many farm and community activities but has devoted the most time to the Iowa Corn Growers Association, the National Corn Growers Association, the Iowa Corn Promotion Board and the U.S. Feed Grains Council. He has held several positions in these organizations, including a 2-year term as chair of the Iowa Corn Promotion Board.

For the past 3 years Derryl has chaired the Farm Credit Task Force of the National Corn Growers Association where he has worked on farm credit legislative initiatives. In 1986, Derryl was recognized by the Des Moines Register in its listing of leaders across the State of Iowa under the age of 40.

I believe Derryl's own words perhaps serve as one of the best introductions. He said, and I quote: "I am a farmer by choice with a deep appreciation of the social, community and family fabric of rural agriculture."

Well, Mr. Chairman, I believe that this type of attitude and philosophy must guide the Farmer Mac Board if it is to provide effectively the economic leg-up to family farmers, ranchers, and rural communities envisioned in the Farmer Mac legislation.

I am proud that Derryl is one of the nominees and I am proud to join with my colleague, Senator Grassley, in introducing him here today.

The CHAIRMAN. Thank you.

Senator Grassley.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Mr. Chairman, it is a pleasure for me to join Senator Harkin in endorsing and asking favorable consideration by this committee of the nomination of Derryl McLaren to this Board.

I have had a long association with Derryl and have come to trust his judgment and to rely upon his sound advice. Derryl is not only a farmer but, as Senator Harkin said, active in many organizations. He is most active with the National Corn Growers Association, but he has also been involved with the U.S. Feed Grains Council, the American Farm Bureau and served on several agricultural advisory committees for Iowa State University.

As an active member of the Iowa National Corn Growers Association, Derryl has been a frequent visitor to my office. He has an in-depth understanding of business, international trade, farm credit and general agricultural policy. Certainly Derryl's résumé reveals great involvement in agriculture and community but the résumé

90-472 - 88 - 2

gives only a partial picture, Mr. Chairman. Those of us who have known Derryl also know of his commitment to farming, his interest in agricultural economics and credit matters, and most importantly, his tenacity in finding solutions to challenges facing agriculture.

I am particularly pleased that Derryl's nomination will ensure that small rural banks, a vital component in farm finance, will be represented on the Board. I am also pleased that the Senate Agriculture Committee is acting on the nominations now, thus maintaining the momentum started by the Interim Board and initial stock issuance.

While I do not serve on this committee, Mr. Chairman, many of you know of my deep interest in the establishment of the agricultural mortgage secondary market. The review of the nominations for Board members by this committee is but the first step in a long process, the end result in the long term being affordable credit, to the great benefit not only of Iowa farmers but also to farmers across the country.

Derryl McLaren knows the needs of farmers. He understands the Agricultural Credit Act of 1987, and most importantly, he recognizes the importance of extending to farmers the benefits now available through secondary markets for housing and education loans. Farmer Mac will be similar to those predecessors, providing outside capital to thus meet the needs of agricultural finance.

I hope this committee shares my enthusiastic support for Derryl's nomination to serve on the Board of Directors for the Federal Agricultural Mortgage Corporation. His membership on the Board will provide the experience and the common sense necessary to ensure that the agricultural secondary market serves the needs of farmers in the United States.

Thank you.

The CHAIRMAN. Thank you very much. I might note, Mr. Williamson, your parents are here, are they not?

Mr. WILLIAMSON. That is correct; my father, Dr. Ed Williamson, Auburn University, retired professor, my mother, Ruth Williamson, and my aunt, Ethel Day of Virginia.

The CHAIRMAN. It is nice to have you all here. I know how over the years when my parents have come down here and people have been kind enough to say something nice about it, they have appreciated it. But we want you to know, all the Williamson family, that everything said here, of course, being in this committee, is the absolute truth, all those fine things said about your son. I am sure you appreciate that.

Mr. WILLIAMSON. I have always told my mother that.

The CHAIRMAN. She is probably the only one that believed it, if she is like my mother. [Laughter.]

Let me ask, if I might, the basic question that I will ask of each of the three of you.

Mr. Southern, I hope you do not feel that you have been neglected here in these introductions. Your Senators have made it a point to let Senator Lugar and I know how much they support your nomination here.

Mr. SOUTHERN. Thank you, Senator. Excuse me. I think the Washington climate is getting to me, too.

The CHAIRMAN. It will do that.

Mr. SOUTHERN. Sir, may I make a short comment?

The CHAIRMAN. Sure, please.

Mr. SOUTHERN. I am a farmer in the Missouri "Bootheel", in the Delta along the Mississippi River and I raise cotton, soybeans, wheat, milo, and corn. I have been farming for over 30 years except during brief tours of duty with the Army. I do not have a background of an economist or a legal background or a CPA, but I am a farmer and I have had a lot of experience in borrowing money. From that standpoint, I am very much a proponent of the Farmer Mac and I have been helpful, I believe, to my congressional delegation the past several years in the secondary mortgage feature and I have been very active in that.

I believe it is great for our country, for the field of agriculture—and some of my colleagues did not make it the last several years in farming because of the poor financial structure. If we can solicit and get wider participation in financing of agriculture—and it is big business nowadays—it will help us all, and I believe the long term, fixed interest rates, what we are looking for will be a product of Farmer Mac. I am a strong proponent.

Thank you.

The CHAIRMAN. Thank you. Well, I am pleased to hear those comments and I appreciate your making them. I am sure you would want to note one further point for the record. You said you have had long experience in borrowing money. I would assume you have also had long experience in paying it back, too. [Laughter.]

I did not want to leave that kind of dangling out there.

Mr. SOUTHERN. Yes, I appreciate that comment, Senator. So does my banker.

The CHAIRMAN. Well, let me ask this question. I will start with Mr. Williamson, then Mr. McLaren and then Mr. Southern.

Mr. Williamson, if your nomination is approved by the committee and the Senate, do you promise to respond to requests to appear and testify before this committee or any other duly constituted committee of the Senate?

Mr. WILLIAMSON. I will.

The CHAIRMAN. And if you are confirmed by the Senate, will you faithfully execute the laws passed by Congress regardless of any prior statements you have made or biases you may have held?

Mr. WILLIAMSON. I will.

The CHAIRMAN. Mr. McLaren, same answer?

Mr. MCLAREN. Yes, sir.

The CHAIRMAN. And Mr. Southern?

Mr. SOUTHERN. I will.

The CHAIRMAN. Thank you. Also Mr. Williamson, do you agree that you would have to disqualify yourself from any board action or deliberation affecting any bank or financial institution with which you do business on a private basis?

Mr. WILLIAMSON. That is correct.

The CHAIRMAN. Now, you served along with Mr. Dahl and Mr. Benston as a member of the Interim Board. How do you feel about the various factions that have been involved on that Board? Do they seem to be working together? Are you getting information from them?

Mr. WILLIAMSON. It certainly has been an experience, Senator. I, like George, frankly, knew nothing about it. I feel, as Chairman Jack Dahl said, it could not be any more harmonious, the Board. It is diverse. We have Farm Credit people. We have ABA, the IBA. We have insurance, and then Jack and myself as farmers, and then George Benston, Professor Benston. I get tickled at the questions from George Benston about the banking, from the banking world.

Well, the meetings, what I get from George Benston, I am interested in farming. The bankers are interested in banking. George Benston is interested in the citizen, the public that is not represented there. So we get all angles.

Yes, it is very harmonious. It has been quite an experience. As Senator Fowler mentioned, I served in the FmHA Board locally in South Georgia. It is very typical of other agricultural areas. Times are not good.

Most of the family farms are now owned by foreign owners, retired corporate executives who now call them plantations. They allow the families who had had the farms for generations to live out their lives in the house which they no longer own, along with the land.

Unfortunately, I guess that's life. My brother-in-law and I farm together. We farm pecans and peanuts, corn and soybeans, as Senator Fowler said. I do not think we are as good farmers as my father-in-law. I am sure as heck not as observant as he is. The difference is we are probably better business people in that we are surviving.

I not think I will ever accumulate the money he can accumulate as far as business. I am not talking about that type. I am talking about survival. We have to do a heck of a lot better job. We know what goes into producing pecans. We know what we have to do to market pecans. In the past, frankly, they did not have to do that. So I guess there's good things and bad things about the change.

I think the good thing about this Farmer Mac is now the farmers that have survived are going to have an opportunity, if the times change and become depressed once again, that there is another avenue for us to survive, a long secondary mortgage avenue, which was not there earlier. And my friends who are farmers, the bankers in this area, and agriculture feel the same way.

The CHAIRMAN. Thank you. Let me ask Mr. Southern: Do you agree that the Interim Board's bylaw on conflict of interest, article III, section 9, requires that you must disqualify yourself from any Board action or deliberation affecting a bank or financial institution with which you do business on a private basis?

Mr. SOUTHERN. I certainly do.

The CHAIRMAN. And Mr. McLaren, you would agree with that, would you not?

Mr. MCLAREN. Yes, sir, Mr. Chairman.

The CHAIRMAN. Mr. Southern, in an August 1985 speech to the Pemiscot County Farm Bureau, you supported proposals to allow the general public to invest in farmlands, and in particular, you argued that an "Aggie May plan" could result in livable interest rates for the distressed farmer and would not be a budget buster to the Federal Treasury.

Do you still hold those same high hopes for the Farmer Mac idea?

Mr. SOUTHERN. Yes, I do, Senator. At that time we did not have any other name for it. There were several names put out. Aggie May was one of them. But that is the secondary mortgage feature, and Farmer Mac came out of it. I am still a strong supporter of that.

The CHAIRMAN. Mr. McLaren, you are currently a director both of the National Corn Growers and the Iowa Corn Growers Association. How do you feel that your involvement with these groups will affect your views toward issues before the Farmer Mac Board? Are there special sensitivities, for example, among growers, whether of corn, soybean, wheat or other crops, which have to be addressed and developed in the Farmer Mac program to make the program successful?

Mr. MCLAREN. Yes. My involvement in that respect, I would certainly not take any views to the Farmer Mac Board and, if necessary, I would resign or disqualify myself from those organizations.

The CHAIRMAN. Do any of you see the Farmer Mac program as a threat to the Farm Credit System, or do you think the Farm Credit System benefits by it?

Mr. WILLIAMSON. Without a doubt it will benefit, just through competition alone, Senator. The local banks, or the independent banks in my small town, need this for another source of money to lend.

The CHAIRMAN. You see this as helping competition, not killing the competition?

Mr. WILLIAMSON. Very positive.

The CHAIRMAN. Mr. McLaren, do you see it the same way?

Mr. MCLAREN. Absolutely. It will greatly increase competition out there and that is something that we really need. That is something that has been lacking over the last few years.

The CHAIRMAN. Mr. Southern, is competition good for everybody there?

Mr. SOUTHERN. I think so in the Farm Credit Service. The Federal land bank, which does handle the long-term loans, which I have had a lot of experience in, certainly they should take advantage of Farmer Mac, and I believe they will, and yes indeed, the more competition the merrier. The more money out there, the better off we all will be.

The CHAIRMAN. I will have other questions for the record.

Senator Lugar.

Senator LUGAR. Mr. Chairman, I would just like to ask any one of you or all of you, following up the Chairman's question about competition, clearly during the testimony we had prior to passage of the bill, the Farmer Mac provision was supported by banks of all sizes around the country. This was true of country banks as well as large banks. Also, it was generally supported by farmers who saw potential sources of credit and through that competition, hopefully lower rates.

I suppose you know the question, that we keep asking is what the effects are going to be on the Farm Credit System? Some of the testimony was that it could be fairly devastating. If the Farm Credit System did not shape up, if people did not become sharper

in their own management abilities, whole sections of the Farm Credit System may fall away under the competition. This is why we were in the resurrection phase last year.

I suppose the question that I would ask you is sort of a reach into the unknowable. To what extent, in your service as Board members, do you see it a responsibility to survey the general scene, from the standpoint of farmers who want additional credit and competition, of a healthy banking system, and likewise of continuation of the Farm Credit System, or do you feel that this is something that simply sort of falls where it may?

In other words, if you work toward efficiency in the market and the Farm Credit System falls by the wayside, is that just the way it goes, or are you prepared to bring reports to us of what you perceive is occurring in the total farm credit picture?

I would tell you, frankly, some of the testimony we heard suggested that Farmer Mac was required because we could see deterioration of farm credit. In some States there would be nothing else left, and therefore it would be useful to have the secondary market so that there would be at least a thin veneer of credit opportunity available for producers throughout the country.

Do you have any overall observations about the course of things as you can see them?

Mr. WILLIAMSON. I really do not.

Senator LUGAR. We are just sort of entering into this situation to see how it works?

Mr. WILLIAMSON. Pretty much, right. Farm credit is a difficult thing in a small town and we, frankly, need our small, independent banks. Unfortunately, we are seeing more of these Atlanta banks coming down and buying these small banks, and that is not positive.

See, this is more to me than farming and banking. This is a way of life. When we get large banks out of Atlanta coming and buying our small banks, that is not positive for the farm world and I think just in an overscope of it, yes, we need this. We need this for the independent, the Farm Credit banks, and our rural America to survive.

Senator FOWLER. Since I will get away with it, with very little press here, I want Mr. Williamson to know—he does not know this—and his parents, that I was only 1 of 36 out of 435 in the House of Representatives that opposed our legislation that allowed the big banks to purchase the little banks, our great bank merger bill.

I have been criticized for that so many times, I am glad to have somebody who would agree with me.

Mr. WILLIAMSON. You do not think it does not happen. It does. I created a tennis tournament which, I am proud to say, is the largest tennis benefit in the United States, for the mentally retarded. We have four banks in our community, as Senator Fowler spoke 2 years ago at the benefit. Three of the banks give me $5,000. The bank that is a branch of the Trust Company of Georgia does not give me $5,000. They do not give me $500. They do not give me $100. They do not give me one cent, and they are part of our community. That is not good.

Mr. MCLAREN. Senator, I would like to address that question. I think that is one of the questions that a lot of us had when all of this legislation was being considered and formulated. As time approaches to Farmer Mac actually getting off the ground and making that first loan, a lot of the fears that I had had in that respect are gone.

When you consider that this is a competitive environment that everyone can work in, that by itself makes everyone fairly honest in this game. And then, No. 2, when you consider that the Farm Credit System still has that access to Wall Street, and perhaps its lending scheme is a little different than simply providing itself liquidity because it can access Wall Street on its own.

Senator LUGAR. I appreciated the comment Mr. Williamson made in behalf of Professor Benston, that he was looking out for the public and everybody. I presume, in fairness, all of you see that as your mission.

In other words, although clearly you come with strong backgrounds as farmers, and that is important in terms of the credibility of this to agricultural producers of the country, at least as I perceive, in these positions now you are looking at this situation in behalf of all the taxpayers of the country and the integrity of the system of which you are the guardians and the trustees. Because in the event that it fails, it will reflect upon all of us, those who tried to formulate the legislation and guide it through as well as those who are involved in its administration.

I trust that that simply is the way that you all look at this. You have a farm background, but likewise a sense of trust with regard to all the responsibilities you have.

Mr. WILLIAMSON. The reason I said that about Professor Benston is, yes, sir, I agree with you. But I am a farmer. I am on that Board to represent farmers on the Interim Board which I sat in. I am the only farmer there, because Jack is a rancher. That is different. [Laughter.]

Just like you are from Indiana. I know you are thinking about us down in South Georgia, but I have an idea you are thinking more about your constituents in Indiana. But I think you are absolutely right. I think that is what we are all there for, and we understand that. But where Jack is coming directly from the meetings, have been the citizens, yes, sir, more so than the rest of us; myself, from the farm world.

Senator LUGAR. I appreciate that. I just make the point that I think around this table you are correct. We come from States and we try to do the best we can for our constituents. But I would just say that Senator Leahy's situation in Vermont and mine in Indiana and Senator Cochran's in Mississippi are so diverse that in trying to formulate this system if we had been specifically concerned about each of the farmers we know along the road, we would not have made it.

We really, in thinking of a national system and you as national trustees, need to have that broader vision and I trust that you will.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Fowler.

Senator FOWLER. I will associate myself with the distinguished Senator from Indiana, his remarks, in our charge to you as mem-

bers of the Board. Certainly you represent, and you are called upon and are qualified because of your expertise but somehow that has to translate into a much higher calling when you look at all of your responsibilities in the public interest on behalf of what this Board is trying to accomplish—the more distinguished Senator from Indiana, not only than I, but the real distinguished Senator from Indiana; I would associate myself.

The CHAIRMAN. I have all kinds of comments, but we would have to correct the record after if I made them.

Go ahead, Senator Daschle.

Senator DASCHLE. Thank you, Mr. Chairman. I too share the views expressed by Senator Lugar. You never see parochialism here in the Senate. It just does not exist. [Laughter.]

And if you believe that.

The CHAIRMAN. Especially not in this committee.

Senator DASCHLE. That is right. But, obviously, even though we aspire to avoid parochialism, in your positions in particular, the whole world will be watching. They do here as a matter of course and, obviously, rightfully so. But I think in your case, you are the pioneers here. You are going to be creating the turf upon which many others who follow will tread and it is critical that Senator Lugar's words be adhered to.

Let me just ask a couple of questions, and I think they would be best put to Mr. Williamson.

With regard to the bankers that Senator Lugar was addressing, if I went home this weekend and were asked by my bankers, when can we participate, what should I tell them?

Mr. WILLIAMSON. Our Chairman, Jack Dahl, answered this earlier and did a lot better job than I, since he sits in all the subcommittees. He is talking about going into effect, I believe he said, the middle of 1989.

Senator DASCHLE. So it will be another year yet, roughly.

Mr. WILLIAMSON. Is that correct, Jack?

Mr. DAHL. I hope we would be operational by the middle of 1989.

Mr. WILLIAMSON. Be operational by 1989. We are still beginning.

Senator DASCHLE. Will there be a requirement that only banks who hold stock will be eligible to participate?

Mr. WILLIAMSON. I believe that is going to be true. Of course, Henry Edelman might better be answering these questions instead of me. That is franchised stock.

Mr. EDELMAN. I would not characterize it as franchised stock.

Mr. WILLIAMSON. OK. That is the reason I better turn this to Henry.

Mr. EDELMAN. It is being considered as user stock and, of course, the Board has not acted on that.

Senator DASCHLE. If that were the case, how would you ensure that the small banks we have talked a lot about this morning would have the opportunity to participate and would even be informed of opportunities?

Mr. WILLIAMSON. We are in the process of doing this, Senator. They are talking about—this is another world for me. Last week I was spraying pecans in a tractor. Today I am telling you how we are going to sell $20 million worth of stock. [Laughter.]

They have things called a road show, and we have hired First Boston to handle this, and the nice part about this, Senator, the bankers are well-represented on this committee. There is one from the ABA, Tom Olsen from Nebraska, and Randy Callabrew from the—no, it is IBA, and Randy Callabrew is ABA, from a banker in Illinois. And they are very conscientious about this because they are both small bank presidents and they want the time—this has been laid out clear to both Henry and First Boston—that they want time in which they can organize themselves, the small banks throughout the Midwest and, sure, in the South where I am from, that they will be educated and have the opportunity to take advantage of this as well as the big boys such as Prudential.

This is real clear. They have a lot of power in these meetings and I think without a doubt Henry understands this, the rest of the Board understands this, and that is the way it is going to happen.

Senator DASCHLE. Well, we have two Midwesterners on the Board. Missouri and Iowa have a lot of small banks that are very interested in this and it is going to be one area that I personally want to pursue as we go through this and watch as carefully as we can.

When I voted on this legislation, I set parochialism aside, but I have to say that there are concerns, regardless of whether you are in Georgia, as you said, or South Dakota, with regard to the ability that small banks have to use the same tools, the same financial resources, as the big guys. And that is going to be critical as you address those two issues.

One other issue that will be critical is the whole issue of poolers. Do you have any idea how many poolers ought to play a role in this? Have you thought about whether it ought to be several, one, three? What would you say? What would be your guess at this point?

Mr. WILLIAMSON. Well, you are talking something way out of my expertise. Just listening to the Board, we are talking about several.

Senator DASCHLE. Does anybody have any problem with that? I mean, I hope that it is several.

Mr. SOUTHERN. There will be several, and it must be because it must be geographically distributed and also the Farmer Mac statute states that it must be well represented.

In other words, it will not all be cotton farmers in that mortgage pool; a broad source of farmers involved in each pool. So that will cover a large area, certainly. But I think perhaps the Farm Credit System and the banks may get together and work together on this to some extent. I see no reason why they should not or could not.

In other words, a large Farm Credit System area may have a pooling—a certifying facility, and they may be soliciting business from the originators, which may be banks. And that has never happened before and I think that is good.

Mr. MCLAREN. Senator, the integrity of the system is going to be under great scrutiny at the beginning and I think you raise some very good points and I would agree with my two colleagues.

Senator DASCHLE. Well, thank you, Mr. Chairman. I have other questions, but I know there is some concern for time, and I will submit those for the record.

The Chairman. We appreciate it very much.

If there are no further questions, we will hold the record open for a couple of days for questions for the record.

[The biographical information of Messieurs Williamson, McLaren and Southern can be found at the end of the hearing.]

The CHAIRMAN. Gentlemen, I appreciate all of you being here, all five of you. I must point out again, as I did earlier, that a lot of us took a little bit of a plunge of faith in passing this legislation. We want to see it work. We realize that a lot of it is going to be determined by how good the people are who are running the Board.

I can assure you that this committee will keep fairly constant oversight on what is going on. We don't want to meddle, but we are concerned and want to make the program work. We really want to make it work.

If any of you have problems with the way it is going, if there are things that you think we have not looked at, do not hesitate to just drop me a line personally and we will look at it. I think I can speak for every Republican and every Democrat on this committee on this. We do want it to work and I think it will.

Thank you. We stand in recess.

[Whereupon, at 11:20 a.m., the committee was adjourned, subject to the call of the Chair.]

[Material submitted for inclusion in the record follows:]

Opening Statement for Jack Dahl
Senate Agriculture Committee
September 13, 1988

Thank you Mr. Chairman and Members of the Committee.

As you know from my introduction I am the Chairman of the Interim Board of Directors of the Federal Agricultural Mortgage Corporation (Farmer Mac). Nine of us were appointed by President Reagan and were sworn in by Secretary of Agriculture Lyng on June 16, 1988. Since that time, we have been actively meeting and aggressively moving toward the issuance of the initial stock offering in a minimum amount of $20,000,000 and the establishment of Farmer Mac's operations.

The Interim Board of Directors has, since its first meeting, operated with the spirit of full cooperation from all segments represented. Discussions have been open and penetrating. We have moved deliberately. Among other decisions, the Interim Board opted to employ no paid staff members prior to the stock offering, thus leaving that responsibility to the Permanent Board. The services of three consultants have been retained: James Murray of Brown and Wood as Legal Counsultant; Henry D. Edelman of PaineWebber as Financial Consultant; and C. W. McMillan of McMillan and Farrell Associates as Coordinating Consultant.

Since there was no "start-up" money provided, Farmer Mac has signed a commercial bank borrowing agreement in the amount of $500,000 in order to get the Corporation up and running. After an extensive selection process, the Board on August 26th chose The First Boston Corporation to be the lead underwriter in the

initial stock issuance. If all goes as planned, the Offering Circular will be issued in early October, thus setting the stage for the sale of the Class A and Class B voting common stock.

There still are some policy decisions that have to be made before the stock offering is consummated, because purchasers will be both investors in and "users" of Farmer Mac. The criteria for eligibility to be a pooler or originator must be set prior to the stock offering; the minimum stock purchase must be set for each category; and there will need to be preliminary determinations of standards for appraisals, credit underwriting and loan documentation. Each of these needs to be a addressed in disclosures in the Offering Circular.

The Interim Board is limited by The Agriculture Credit Act on certain policy decisions, such as standards for appraisal and credit underwriting. However certain tentative determinations must be made as recommendations for approval by the Permanent Board. For example, the statute requires the Permanent Board to establish appraisal and credit underwriting standards within 120 days after the Permanent Board is seated. The Interim Board is conscious that the decisions it makes now are only of a temporary nature and will be in the form of recommendations to the Permanent Board. To ensure a successful stock offering in compliance with relevant securities laws, we need to take some of these steps while recognizing that the statute creating Farmer Mac delegates the first decisions to the Permanent Board.

It is timely and necessary to have the public members

confirmed by the Senate before the conclusion of the 100th Congress. As you can see from my comments, the Interim Board has placed Farmer Mac on a fast track with momentum and anticipation from all parties involved -- the borrowers, the originators, and the poolers, etc. We are confident that the initial stock offering will be concluded expeditiously and without any major problems if all parties continue to move as they have so far. The Permanent Board could take over full responsibility for the running of the Farmer Mac as early as January of 1989 if all goes well. Having the public members confirmed and the early election of board members from holders of Class A and Class B voting common stock can provide an expanded opportunity to meet the financing needs of agricultural producers and rural housing.

Thank you again for having these hearings. My colleagues currently serving on the Interim Board may wish to make additional comments or observations.

BIOGRPHICAL INFORMATION [PUBLIC]

1. Full Name: John Reed Dahl

2. Address: Route 1 Box 82 Gackle, No. Dak. 58442
   Telephone 701-485-3206

3. Date & Place of birth: 1-15-1930 Fargo, No. Dak.

4. Marital status: Married---Dorothy Lee Davis--Housewife

5. Education: ND State University 1946--1951 BS

6. Employment record: June 1954 to present--Self-employed Partner in Dahl Land & Cattle Co. & Dahl Land Associctes. Have never been an officer or director of any financial institution or entity.

7. Military Service: U S Army--July 1952 --1954
   Honorable discharge---Rank of Corporal.

8. Goverment Service: None

9. Honors & Awards: N.D. Man of the Year in Agriculture
   N.D. National Leadership Award of Excellence

10. Political Affiliation: Republican

11. Other Memberships:
    National Cattlemen's Assn.
    N.D. Stockmens Assn.
    National Livestock & Meat Board
    Northwest Farm Managers
    N.D. Farm Bureau
    U.S. Animal Health Assn.
    American Hereford Assn.
    American Salers Assn.
    American Legion
    Dakota Medical Foundation

12. Published writings: None

13. Health: Good

FINANCIAL DATA AND CONFLICT OF INTERST (PUBLIC)

1. If confirmed, do you have any plans, commitments, or agreements to pursue or continue outside employment or engage in any business or vocation, with or without compensation, during your service with the government? (If so, explain.)

   Yes - Will continue present business involvement with Dahl Land & Cattle Co. & Dahl Land Associates.

2. List sources, amounts and dates of all anticipated receipts from deferred income arrangements, stock options, incompleted contracts and other future benefits which you expect to derive from previous business relationships, professional services, firm memberships, former employers, clients, or customers.

   None.

3. Do you, or does any partnership or closely held corporation in which you have an interest, own or operate a farm or ranch? (If yes, please give a brief description including location, size and type of operation.)

   Yes - Approximately 7000 acres of farm & ranch land in Logan county, North Dakota.

4. Have you, or any partnership or closely held corporation in which you have an interest, ever received a direct or guaranteed loan from or cosigned a note to the Farmers Home Administration or Farm Credit System? (If yes, give details of any such loan activity during the past five years.)

   Yes - $150,000.00 long term real estate loan with the Federal Land Bank. Loan is current.

5. Do you have any plans to resume employment, affiliation, or practice with your previous employers, business firms, associations, or organizations after completing government service? (If yes, give details.)

   Yes - See No. 1

6. Has anyone made a commitment to employ you or retain your services in any capacity after you leave government service? (If yes, please specify.)

   No.

7. Identify all investment, obligations, liabilities, or other relationships which involve potential conflicts of interest in the position to which you have been nominated.

   None.

8. If confirmed, explain how you will resolve any potential conflict of interest, including any that may be disclosed by your responses to the above items.

   None.

Jack Dahl
RR #1, Box 82
Gackle, ND 58442

Response to Questions from Senator Tom Daschle

Question 1. As Chairman of the Interim Board, you are charged with the responsibility of making the $20 million initial stock offering. When can a bank in South Dakota expect to fully participate in the Farmer Mac program?

Answer. The current plan of the Interim Board is to begin the offering of the voting common stock in early October, 1988. The first step will be the distribution of a preliminary offering circular in early October. We expect to complete the stock sale in the latter part of November, 1988. The special meeting of the shareholders and the election of the Permanent Board should be conducted after the stock sale and Senate confirmation of the Presidential appointees to the Permanent Board. We expect the Permanent Board to meet for the first time in January, 1989. As the law requires, we anticipate that the Board will set the terms necessary for Farmer Mac to be operating within another 120 days. Accordingly, we would expect that a bank in South Dakota will be able to participate in the Farmer Mac program by the middle of 1989.

Question 2. Will there be a requirement that only banks that hold stock in the corporation will be able to participate? If that is the case, how will you make certain that small banks with less capital will not only be informed about the offering, but also have a chance to compete for the offering? In addition, what should be the role of small banks in Farmer Mac?

Answer. The Interim Board has not decided whether banks will be required to hold stock to participate as "originators" and "poolers" in the Farmer Mac program. Whatever decision the Interim Board makes on this question, we want to be sure that banks of all sizes, including small agricultural banks, are fully informed about the stock offering. This will be accomplished during the offering period through meetings with banks and with the use of video tapes for those banks that cannot attend the meetings. One of our goals is to make sure that the small agricultural banks are able to act as "originators" in the programs of Farmer Mac. We expect that such activities by small banks will make the Farmer Mac program successful.

Question 3. The Board is empowered to certify "poolers" who meet eligibility standards established by the board; do you have any views on the number of poolers that should exist in order for the secondary market to be efficient?

Answer. At this time, we do not have a definite view on how many existing or newly-created poolers will qualify under Farmer Mac's eligibility requirements. We expect that there will be many institutions interested in becoming certified as "poolers." I do not have any firm view on the number of poolers necessary in order for the secondary market to be efficient. Obviously, the more poolers there are and the more competition there is, the result should be greater availability of loans and lower interest costs for the borrower, which is the result we all want. At the same time, while seeking to increase the number of poolers, we must be sure that Farmer Mac does not loosen its standards and permit weak or unqualified financial institutions to become poolers.

Jack Dahl

Jack Dahl
RR#1, Box 82
Gackle, ND 58442

RESPONSE TO QUESTIONS FROM SENATOR HARKIN

1. Q. What role do you envision for the Farmer Mac system in revitalizing the economics of rural areas?

   A. What the economies of rural areas need most is long-term, fixed rate loans. Farmer Mac's role should be to facilitate the availability of financing on these terms. This will permit farmers and ranchers to make investments in their own means of production -- "capital investments" that will ultimately improve the efficiencies of their operations. In addition, these loans may be used to provide working capital with long-term availability at a predictable cost. By increasing the liquidity of originator banks, Farmer Mac will make new sources of funds available to aid the economies of rural areas.

2. Q. Do you believe that Farmer Mac should develop specific policies designed to help communities and areas of the country that have special problems of inadequate capital and credit or weak economies?

   A. Farmer Mac has developed a specific policy to ensure that the offering of its common stock reaches the broadest possible audience of potential originators. A broad network of originators should make Farmer Mac guarantees available for loans to farmers and ranchers in areas that suffer from inadequate capital or credit. While Farmer Mac should be able to provide these resources at competitive rates, it should be cautious in developing policies to address areas with weak economies. In those areas, it should only guarantee loans with sound economics. Farmer Mac is not, to my understanding, intended to serve as a "lender of last resort" to weak borrowers and I would not recommend that it be operated as such. Within the limitation just mentioned, Farmer Mac's flexible underwriting and appraisal standards will help areas with weak economies. Farmer Mac should develop educational programs to acquaint agricultural lenders with the benefits of the secondary market which should bring expanded sources of credit to rural areas that have suffered from inadequate capital.

3. Q. What should the Farmer Mac board do to address the problems cited in the previous question?

   A. Farmer Mac should take steps -- as we are now doing -- to be sure that originators and poolers in rural communities with less than adequate credit availability be identified and urged to participate in its program. As agricultural lenders become more familiar with the secondary market, agricultural lending will become more attractive and additional capital will be brought to rural areas. An extensive investor education program, explaining both the value of being a Farmer Mac originator or "pooler" and the investment potential of the common stock, is being planned for October and November.

4. Q. Do you foresee problems of Farmer Mac backed loans going predominately to an exclusive set of only the very best loan prospects?

   A. I believe that Farmer Mac-backed loans will be originated through a highly competitive system that will be forced to seek out borrowers beyond "the very best loan prospects." Flexible underwriting and appraisal standards would facilitate this. Those underwriting standards will not attempt to discriminate against any borrowers who meet the underwriting standards approved. Competition among originators will ultimately benefit a wide spectrum of borrowers.

5. Q. What special policies, if any, should the Farmer Mac board implement to ensure that the benefits of the Farmer Mac system are made available to the broadest possible range of borrowers and financial institutions in terms of financial situation and geographic location?

   A. In addition to establishing a wide network of originators, Farmer Mac should take steps to be sure that there is a sufficient number of poolers, particularly for regions of the country not served by larger financial institutions. Originators will shop for the best pooler. Poolers, in turn, will market their services to as many originators as they can possibly reach. By alerting agricultural lenders to Farmer Mac programs and the benefits of the secondary market for agricultural real estate loans and housing loans in the manner I have just described, Farmer Mac

will make its programs available to a broad range of financial institutions and borrowers.

6. Q. Do you believe that the Farm Credit Administration has the particular financial expertise necessary adequately to protect the public's interest in its regulation of Farmer Mac? (FCA approved Farmer Mac regulations at its 9/6 board meeting.)

   A. While I am not familiar with the particular financial expertise of the Farm Credit Administration, I would expect that its experience should form a good base of understanding. I also take comfort from the fact that Congress has selected the FCA for this purpose.

7. Q. Given the federal guarantee backing Farmer Mac, how can the Farmer Mac board help to protect the public interest from unforeseen circumstances, such as another drought? Will Farmer Mac be capable of dealing with a crisis?

   A. Viewing the protection of the public interest as prevention of a call on the federal guarantee backing Farmer Mac, I believe the legal requirements as to commodity and geographical diversification should serve this purpose. By adopting reasonable underwriting and appraisal standards for the agricultural real estate and rural housing loans to be pooled, Farmer Mac will insure that a temporary crisis, such as a drought, does not impair the integrity of the securities backed by the Farmer Mac guarantee. Also, Farmer Mac will review each pool of loans prior to placing its guarantee upon the senior bonds and determine the appropriate level of subordination, which will always be at least 10%. In addition, Farmer Mac's capital, obtained through the public offering of its stock and through retention of earnings, should make it capable of dealing with a crisis.

Jack Dahl

Senate Committee on Agriculture, Nutrition, and Forestry

Questionnaire for Nomination to the Board of Directors of the Federal Agricultural Mortgage Corporation

BIOGRAPHICAL INFORMATION (PUBLIC)

1. Full name
   George J. Benston

2. Address
   Home: 372 Knollwood Drive, Atlanta, GA 30305; (404) 233-6424
   Office: Graduate School of Business, Emory University, Atlanta, GA 30322; (404) 727-7831

3. Date and place of birth
   March 18, 1932, New York, N.Y.

4. Marital status
   married to Alice N. (Schwartz) Benston, who is Associate Professor of Theatre Studies and Women's Studies and Director of Interdisciplinary and Special Programs in the Graduate School of Emory University, Atlanta, GA 30322

5. Education
   Queens College, New York, NY , Sept. 1948 - Dec.1951 B.A. granted 2/52
   New York University, Graduate School of Business Administration, New York, NY, Jan. 1952 - Dec. 1952, M.B.A. granted 6/53
   University of Chicago, Graduate School of Business, Chicago, IL, Sept. 1958 - June1962,
   Ph.D. granted 8/63

6. Employment record
   1952 - 1953, junior accountant, David Shain & Co., CPA, NY, NY
   1952 -1953, accountant, Benjamin Smith & Co, CPA, NY, NY
   1956 -1957, accounting and tax specialist, First National Bank of Atlanta, Atlanta, GA
   1566 -1958, instructor and assistant professor of accounting, Georgia State University, Atlanta, GA
   1962 -1966, assistant professor of accounting, University of Chicago, Graduate School of Business, Chicago IL
   1963 (summer), visiting assistant professor of finance, University of California, Berkeley, CA
   1966 -1969, associate profess or accounting and finance, University of Rochester, Rochester NY
   1969 -1987, professor of accounting, economics, and finance, William E. Simon Graduate School of Business Administration, University of Rochester, Rochester NY
   1973 (spring), visiting professor, London Graduate School of Business Studies , London School of Economics, London England, England and Hebrew University, Jeruselem Israel
   1979 (summer), Arthur Young McClelland Moores distinguished visiting professor, London Graduate School of Business Studies, London England
   1981 (Lenten term) visiting professor of accounting, London School of Economics

BIOGRAPHICAL INFORMATION (PUBLIC) CONTINUED

6. Employment record continued
   - *1987, John M. Olin distinguished visiting fellow, Templeton College, Oxford University, Oxford, England*
   - *1979 - present, invited lecturer, Law and Economics Center, George Mason University Law School (programs of economics and finance for federal judges and law professors)*
   - *1985 - present, honorary visiting professor, City University, London England*
   - *1987 - present, John H. Harland professor of finance, accounting and economics, Graduate School of Business and professor of economics, the College, Emory University, Atlanta GA*
   - *1982 - present, president, George J. Benston, Inc., Atlanta GA (consultant)*
   - *1977 - 1981, trustee (elected), College Retirement Equities Fund (CREF)*

7. Military service
   - *1953 - 1956 (active duty), 1956 - 1961 reserves), U.S. Navy, Ensign and LTJG, service number 568439, honorable discharge*

8. Government service
   - *1964 -1965, consultant to the Banking and Currency Committee, U.S. House of Representatives*
   - *1965 -1966, regional economic advisor to the Comptroller of the Currency, Chicago IL*
   - *1966 -1969, consultant to the Federal Home Loan Bank Board, Washington DC*
   - *1970 -1971, consultant to the President's Commission on Financial Structure and Regulation (Hunt Commission)*
   - *1970 - 1972, consultant to the National Commission on Consumer Finance, Washington DC*
   - *1969 - 1978, consultant to the Federal Reserve Board, Washington, DC*
   - *1981 - 1984, visiting scholar, Federal Reserve Bank of Atlanta, Atlanta GA*
   - *1984 - 1985, 1988, consultant to the World Bank, Washington DC*

9. Honors and awards
   - *1952, Phi Beta Kappa (Queens College)*
   - *1953, Beta Gamma Sigma (New York University)*
   - *1955, C.P.A. examination passes with highest grades in the state (North Carolina)*
   - *1958 - 1959, Woodrow Wilson Fellow (honorary)*
   - *1958 - 1960, United States Steel Fellow*
   - *1960 - 1961, Federal Reserve Bank of Chicago Fellow*
   - *1975, Beta Gamma Sigma Distinguished Scholar*
   - *1980, American Accounting Association Distinguished International Lecturer*
   - *1987, Olin Distinguished Visiting Fellow, Oxford University (England)*

10. Political Affiliation
    Democrat

11. Other memberships
    - *American Economic Association*
    - *American Finance Association*
    - *American Accounting Association*
    - *American Civil Liberties Union*

BIOGRAPHICAL INFORMATION (PUBLIC) CONTINUED

12. Published writings

Please see curriculum vita attached. It includes the following published material by subject:

subject	*books and monographs and comments*	*articles in academic journals and publications*	*research in*	*reviews Cong. Hearings*
accounting:	*3*	*26*		*12*
banking and finance		*7*	*39*	*4*
	29			
urban studies	*1*	*5*		*3*
economics not included above		*1*	*12*	
	8			
other		*2*		*1*

plus work actively in progress on the Glass-Steagall Act, urban mortgage choice and discrimination, audit failure at the Continental Illinois Bank, and analysis of savings and loan failures

13. Health

Excellent

FINANCIAL DATA AND CONFLICT OF INTEREST (PUBLIC)

1. If confirmed, do you have any plans, commitments, or agreements to pursue outside employment or engage in any business or vocation, with or without compensation, during your service with the government?
   Yes. Teaching at Emory University, consulting for George J. Benston, Inc. and directly, primarily as an expert witness and on research projects.

2. List sources, amounts and dates of all anticipated receipts from deferred income arrangements, stock options, incomplete contracts and other future benefits which you expect to derive from previous business relationships, professional services, firm memberships, former employers, clients, or customers.
   salary from Emory University
   salary from George J. Benston, Inc.
   consulting income billed directly and not yet received from law firms for whom I have been engaged as an expert witness and for research conducted for the Trustees of the Banking Research Fund of the Association of Reserve City Bankers

3. Do you, or does any partnership or closely held corporation in which you have an interest, own or operate a farm or ranch?
   No.

4. Have you, or any partnership or closely held corporation in which you have an interest, ever received a direct or guaranteed loan from or cosigned a note to the Farmers Home Administration or Farm Credit System?
   No.

5. Do you have any plans to resume employment, affiliation, or practice with you previous employers, business firms, associations, or organizations after completing government service?
   Yes. Position is part time; I do not plan to change my other present arrangements.

6. Has anyone made a commitment to employ you or retain your services in any capacity after you leave government service?
   Yes, in that I will not change my present other arrangements.

7. Identify all investment, obligations, liabilities, or other relationships which involve potential conflicts of interest in the position to which you have been nominated?
   None.

8. If confirmed, explain how you will resolve any potential conflict of interest, including any that may be disclosed to the above items.
   No conflicts of interest; nothing to explain.

EMORY UNIVERSITY
School of Business Administration

George J. Benston, Ph.D., C.P.A.
John H. Harland Professor
of Finance, Accounting and Economics

Atlanta, Georgia 30322
404/727-7831

August 1, 1988

Ms. Christine Sarcone
Chief Clerk
Senate Committee on Agriculture, Nutrition and Forestry
328A Russell Senate Office Bldg.
Washington, D.C. 20510

Dear Ms. Sarcone:

I neglected to answer the following portion of question 6 on the Committee's questionnaire:

6. Are you now or have you ever been an officer or a director of any financial institution or entity?

No.

I regret any problems I may have caused.

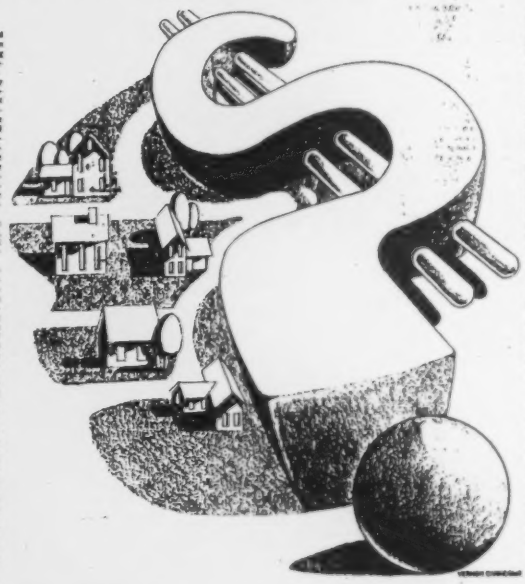
George J. Benston

4C ..... Forum ..... SUNDAY, JUNE 19, 19

The Atlanta Journal ◯ THE ATLANTA CONSTITUTION

Charges of redlining have little foundation in fact

By George J. Benston
Special to the Journal-Constitution



The charge that banks and savings and loans institutions won't grant mortgages on properties in some areas has become a big issue in Atlanta. But allegations of redlining are an old issue for many other cities.

Back in the early 1970s, community groups saw their neighborhoods deteriorating. They believed the banks were at fault. So they went down to the courthouses and painstakingly recorded the amounts of mortgages made by banks and savings and loans in various neighborhoods. Like the findings published recently in The Atlanta Journal-Constitution, the data showed that these institutions made relatively few mortgage loans in the central cities and apparently favored the suburbs. Because of this apparent bias by bankers, the groups charged, the older areas had declined.

But looking at the amounts of mortgage money lent to home-buyers by census tract, as the Journal-Constitution did, cannot provide much information for two important reasons.

First, these data include only mortgages made by certain Atlanta banks. Homebuyers and owners in the allegedly underserved areas may be getting funds from other institutions. Under "mortgages," the Southern Bell Yellow Pages lists 13 commercial banks, 18 savings banks and savings and loans, and 617 mortgage companies. An additional 70 lenders (excluding foreign institutions) are listed under "banks." Thus about 518 companies offer mortgages in the Atlanta area. Yet only 101 of these report data under the Home Mortgage Disclosure Act, and only 14 are listed in the May 1 Journal-Constitution article on banks' home lending practices.

Second, there is no reason to conclude from the census tract data that the Atlanta banks criticized are not providing all the funds demanded from them by qualified borrowers. These banks may have made relatively fewer mortgages in predominantly black neighborhoods because other lenders served the people there better in terms of prices charged, services provided or type of mortgage offered. In particular, mortgage companies rather than banks specialize in making low down payment, FHA-insured mortgages. These mortgages tend to be demanded by people with less wealth, and blacks tend to be less wealthy than whites, all other things being equal.

How, then, can we tell if there is unfair discrimination against older neighborhoods or black borrowers? One way is to look at the prices charged for the loans they received, compared to the prices charged to other borrowers. This comparison has been made for several cities where community groups accused banks of redlining, including New York; Miami; San Antonio, Texas; Cincinnati; Nashville, Tenn.; Indianapolis; Toledo, Ohio; Rochester, N.Y.; and Oakland, Calif. (I colleague and I did four of the studies.)

In each of these cities, researchers worked from samples ranging from more than 100 to almost 1,000 loans. They compared the mortgage terms — interest rates and points, down payment and maturity — in the areas alleged to have been redlined with the terms in areas said to have been favored. For these comparisons, the types of properties, the borrowers' incomes and any other non-racial or non-geographic variables were accounted for statistically.

No significant differences in mortgage terms was found, with one exception: The maturities of mortgages made in some central-city areas were shorter than those of mortgages made on suburban properties. But the pattern of shorter maturities was the same for FHA mortgages as for conventional mortgages. So, if this is taken as a sign of redlining, the U.S. government must "redline" in the same way as do banks. As redlining was explicitly against FHA policy during the period studied, the shorter maturities instead probably reflected the greater risk that the central-city properties would lose value.

Under-appraisals of properties in old or black neighborhoods might be another way that lenders discourage potential borrowers. This possibility was studied in Miami, San Antonio, Toledo, and five New York cities — Syracuse, Buffalo, Albany, Rochester and New York. No evidence of under-appraisals was found.

A colleague and I also studied the profitability of home improvement loans in Rochester, Cincinnati, Nashville and Indianapolis. Homeowners found no problem that was related to the area in which their home was located. Furthermore, there was no area-related difference in the prices they paid for these loans.

But these studies only measure the prices charged for mortgages that actually were made. What about redlining in the form of banks denying applications made by blacks or by people who want to buy houses in older areas? This possibility, like was studied with data from 10 cities. One researcher found somewhat higher denial rates for blacks (but not in allegedly redlined neighborhoods) in Albany, Rochester, Syracuse, Buffalo and New York. Other researchers found no such evidence in Miami, San Antonio, Toledo, St. Louis and Columbia, S.C.

What about the possibility of lenders discouraging minorities, or people wanting to buy property in certain areas, from even filling applications? This possibility was studied in two ways.

Researchers in St. Louis interviewed 116 community leaders, particularly those who had charged banks with redlining. They asked these leaders to identify specific persons who had been unable to get loans. After repeated requests, they were given seven names. Two could not be found, four denied they had had a problem, and the seventh (who got financing elsewhere) appeared to have not met the bank's credit standards.

A cost-saver and? I took a second approach. We interviewed homeowners in the allegedly redlined areas of Rochester, Cincinnati, Nashville and Indianapolis. We reasoned that the people who would know most about potential homebuyers who could not get mortgages would be the homeowners who tried unsuccessfully to sell their homes. Of the 222 unsuccessful home sellers interviewed, 23 (14 percent) indicated that potential buyers had problems getting loans. But only 3 of these (1 percent) said that it might have something to do with the area of the house. None mentioned the race of the potential buyer, even when asked.

In summary, none of the studies of 14 cities found evidence of redlining by area of any sort, and one researcher found some weak evidence of a greater denial of mortgage applications by blacks in four New York cities that is contradicted by evidence from five other cities.

These findings should not be surprising. As noted above, dozens of companies in most cities (hundreds in Atlanta) offer mortgages and home improvement loans to the public. A bank that discriminates simply because of the area of the property or the race of the borrower gives up business to other lenders. The people who suffer are not the borrowers — they have many alternatives — but the banks' stockholders.

Why is it, then, that banks are charged with redlining by community leaders?

Chartered financial institutions make very attractive targets. They are regulated by the federal and state governments, and they and their customers often depend on city services. Therefore they are susceptible to political pressures. Furthermore, they appear to control a great many resources that can be directed to alternative ways. And since they often characterize themselves as serving the public, why should they not be required to serve a particular neighborhood or group?

The problem is that a program of forced lending by banks to particular neighborhoods or people is likely to do more harm than good, even to those it is intended to help.

Loans at below-market interest rates that are tied to properties in particular areas tend to benefit the owners of those properties, not the people who buy them. If a property owner can sell his house with a lower-cost mortgage, the property is worth more and its price will go up. Those who get the subsidized mortgages may be encouraged to buy houses they cannot afford. There is no reason to believe that qualified homebuyers and owners have any problems now in getting funds to buy and improve houses. Therefore, if loans are made to people who otherwise couldn't qualify, they are likely to get into financial difficulties.

If the city compensates banks for making such loans by depositing its funds with those banks or by doing other favors for them, it will be doing so at a disguised cost to the taxpayers. If the banks cannot do the job, they will not be serving their shareholders. Or, the banks might go along with the program but raise their other costs, but then try to get out of the neighborhoods where they have pressure to make unprofitable loans. The result will be a reduction in the banking services that poorer people need the most — shrinking, convenient savings and mortgage areas.

In short, there still is no such thing as a free lunch. Unless valid research shows that a market is experiencing restrictive, racial behavior by banks, unlike all the cities already studied, only damage to the general public can come from interfering with the mortgage market.

George J. Benston is the John H. Harland professor of finance, accounting and economics at Emory University.

FORUM is an outlet for commentary by Georgia residents on issues of local, state or national concern.

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JBR

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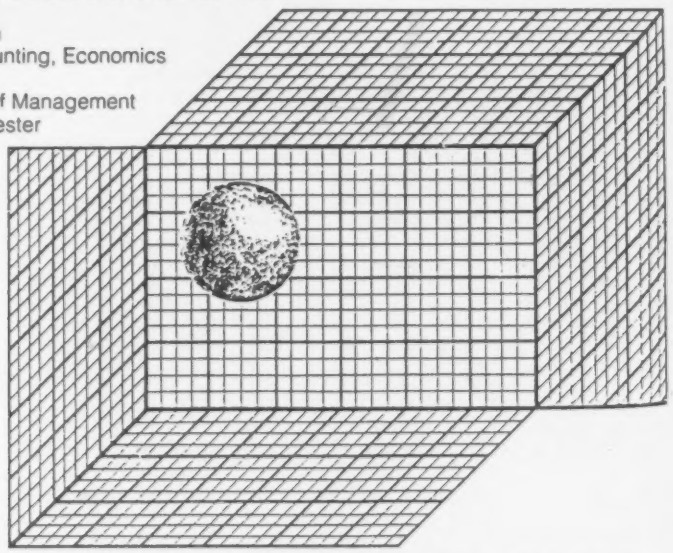
Federal Regulation of Banking: Analysis and Policy Recommendations

George J. Benston
Professor of Accounting, Economics and Finance
Graduate School of Management
University of Rochester



ABSTRACT

Banking has been regulated over the centuries in most countries. The reasons for this pervasive regulation are delineated and analyzed as a basis for suggested changes. Among the nine reasons specified, the most important, historically, was to enhance taxation. This reason and five others discussed are no longer valid, or even are dysfunctional. Only deposit insurance, money supply control and protection of some banking services supplies are currently meaningful reasons for regulating banking. Several suggestions are made that should make these regulations more efficient. Otherwise, unless one wants to protect producers from competition, most laws that regulate and constrain banking should be repealed.

Banking is and has been one of the most regulated of industries. In almost all countries and at all times since the establishment of banking, governments have imposed controls on the institutions, even when most other businesses were free to operate, subject only to the statutes and other general rules of law. In the United States, the extent of regulation has ranged from the free entry banking period of the 1800s, when banks still were supervised and required to maintain specified reserves against the notes they issued, to the extensive controls imposed in the 1930s. The Depository Institutions Deregulation and Monetary Control Act of 1980 removed some regulatory restrictions (e.g., allowing thrift institutions to make consumer and business loans) while imposing others (e.g., requiring noninterest bearing reserves for all

chartered institutions' demand and similar deposits). But as increased nominal interest rates raised the opportunity cost of holding money as deposits at the regulated, chartered financial institutions and as the cost of electronic and telephonic fund transfers declined, the development of products and services designed to avoid the regulations and competition by unregulated providers of financial services increased. It is imperative, therefore, to determine whether the present regulatory structure best serves the public interest and should be extended to all providers of financial services (the level playing field simile), whether regulations should be removed from all providers (perhaps a free-for-all would be a parallel simile), or whether some other restructuring and/or consolidation of the regulations and regulators would be desirable.

However, before changes in the existing order are recommended, the reasons for the past and present regulatory situation should be delineated and analyzed. In this regard, two considerations are likely to be important. First, there were reasons for regulating financial intermediaries more than almost any other industry; should some regulations be removed, the conditions that gave rise to them might re-occur, to the detriment of some people. It is best if the lessons of history are not relearned. Second, the present situation in the United States may make previously relevant regulations no longer applicable or useful. These vestigial regulations impose burdens on society without any compensating benefits. The bulk of the paper is directed toward identifying the antecedents and contemporary relevance of the present set of regulations and regulatory agencies.

The analysis presented in the next section leads to the conclusion that most of the historical reasons for regulating financial institutions are no longer relevant (if they ever were) to our society. These reasons (which are discussed below) include taxation of banks as monopoly suppliers of money, the prevention of centralized power, bank solvency and the effects of failures on the economy, the provision of banking services as a social goal, support of housing and other attempts to allocate credit as social goals, and the prevention of invidious discrimination and unfair dealing against persons. What is needed, therefore, is abolition of most federal regulation. Indeed, with the exception of deposit insurance, the only currently meaningful reason for regulating financial institutions is to control the money supply and protect some suppliers of financial services from competition. Assuming that the last reason is not considered to be desirable and can be overcome politically, almost all restrictions on entry (including intra- and inter-state branching and the offering of all financial products), prices and the restructuring of organizations should be removed. With the exception noted below, financial intermediaries should be treated the same as other corporations.[1]

Consequently, almost all of the *raison d'être* of the federal regulatory agencies would be obviated. In particular the Office of the Comptroller of the Currency (OCC), The Federal Home Loan Bank Board (FHLBB) and the National Credit Union Administration (NCUA) would serve simply as chartering agencies for depository institutions. Because mutuals are not owned by investors who put their resources at risk, the FHLBB and the NCUA would have to act as the ultimate authority that could remove incompetent or dishonest managers. Stockholder-owned institutions, though, would be regulated no differently than other corporations. Charters would be granted to depository institutions if they had deposit insurance provided by an insurer that was approved by the OCC, the FHLBB or the NCUA. The existing deposit insurance agencies—the FDIC, FSLIC and FCUSIF—would be authorized to provide insurance to any depository institutions so that there would be some competition among insurors. (Therefore, it is important that they not be merged into a single agency as has been proposed). In addition, non-government insurers (such as major insurance companies) and banks could be recognized by the chartering agencies and could offer their services to the depository institutions. Because they bear the risk of failures, the insurers would impose whatever restrictions on the activities of the depository institutions that they felt useful, subject to the

[1] The principal regulators for banks would be the state banking commissions and the Securities Exchange Commission (Sec). For an analysis of the disclosure regulations of the SEC and proposals for reform, see my essay, "Security for Investors," in *Instead of Regulation: Alternatives to Federal Regulatory Agencies*, ed. Robert W. Poole, Jr., Lexington, MA: Lexington Books, D. C. Heath & Co., 1982, pp. 169-205.

FEDERAL REGULATION

same sort of mutual agreement that insurance companies exercise with their other clients.

The Federal Reserve Board would cease to have any responsibilities for bank supervision. The payments facilities would be divested and set up as a separate corporation with shares held privately. Reserves probably would continue to be required of depository institutions. And the Fed would lend reserves and provide currency at market rates that were consistent with its mandate to conduct monetary policy.[2] In the further interest of equity and efficiency, the taxes imposed on depository institutions would be the same as those imposed on other corporations. This would require the Fed paying interest on the required reserves and the Congress removing tax subsidies.

In short, it is time that we recognized that financial institutions are simply businesses with only a few special features that require regulation. The following analysis provides the reasoning and evidence on which this conclusion and the recommendations are based.

BASIC REASONS FOR REGULATING BANKING

Taxation

The Historical Record. Perhaps the oldest reason for regulating banking was to enhance the ability of those who had political power, be they monarchs or legislatures, to raise revenues (tax). Before the advent of central banking taxation took two forms: Seigniorage from the production of money and loans at lower than risk-adjusted market rates.

Seigniorage is the difference between the accepted and the commodity value of money. When the government could maintain a monopoly over the money supply, it could require people to use the designated money at its token value by declaring it to be legal tender. Since money costs considerably less to produce than its accepted or token value, the producer (the government) benefits. Even when people could substitute among other forms of money, the convenience over commodities (e.g., gold) of money that was backed by the power of the government to punish forgers enabled governments to obtain seigniorage from the production of money. However, because governments often abused their power to produce legal tender by debasing the currency and printing paper money with apparent abandon, people tended to prefer bank notes produced by private banks. Hence, governments tended to regulate banks for two reasons. One was to restrain the banks' interference with the government's gains from seigniorage. The second was to permit banks to produce money but tax them by requiring them to lend money to the government at favorable rates and/or to give an ownership share to those who controlled the government, e.g., the monarch and his associates.

Government regulation, therefore, took the form of restricting people from the money creation aspects of banking by requiring governmentally granted charters. Needless to say, relatively few charters were granted, since competition among money suppliers would reduce the profits from money creation, profits that could be garnered by government directly, through seigniorage, or indirectly, via loans from and ownership shares in the chartered banks that would be subsidized by the monopoly profits earned with the aid of regulations that restricted their competition.

Loans at less than market rates (net of an allowance for risk) were a favored means by which monarchs and other governmental officials taxed banks. (More accurately, the tax was imposed on the users of bank money, who were prevented from benefiting from competition among banks.) Unfortunately, but predictably, the governments tended to use this form of taxation for revenue to finance extravagances and wars, which led them to enhance further the possibility of the banks achieving monopoly profits that could be taxed additionally (fattening the calf). Sometimes the governments overdid it: loans were defaulted and banks failed (killing the golden goose). Thus a cause of major banking failures was overtaxation by government.

Central banking grew out of the use of banks as a source of governmental revenue.[3] As the bank that served as a revenue source for the government was given more complete monopoly powers and served as the government's primary source of loans, it became an instrument of government—the central bank (e.g., the Bank of

[2] Alternatives to the present system are not considered herein.

[3] See Vera C. Smith, *The Rationale of Central Banking*, London: P. S. King & Son Ltd., 1936.

England). The existence of a central bank permitted the government to enhance its revenue from seigniorage since the notes of the bank tended to become the only legal tender (they were the only notes accepted in payment of taxes). Ocassionally this led to extreme excesses, as in the case of the monopoly given to John Law in 1716 for his Banque Generale, which issued notes with such abandon that the bank failed within five years, bringing the economy of France down with it. But most often, the central bank used its monopoly powers effectively, which included restraining excess production of notes and using the power of government to prohibit or control the issue of notes and deposit services by competitors.

Probably because of their experiences with the near-monopoly powers of the Bank of England,[4] the U.S. founding fathers generally were against the establishment of a central bank, whether privately or governmentally controlled. For this reason, together with the preeminence of states' rights and the desire of existing banks to avoid the dominance of a strong national bank, banking was regulated by the states until 1863, with the exception of the First and Second Banks of the United States, whose 20 year charters were not renewed when they expired. Prior to the National Currency Act of 1863 and National Banking Act 1864 (which established federal chartering), state chartered banks often were required to hold state bond issues as backing for their notes.[5] The national banks (the notes of which supplanted the state banks' notes when the National Banking Act of 1864 imposed a prohibitory tax on them) were required to keep U.S. obligations as collateral. While concern for the note holders was an important reason for this requirement, it also benefited the governments involved. State and federal reserve requirements on demand deposits similarly reflected the governments' interests.

The creation of the Federal Reserve in 1913 gave the United States its first central bank. By requiring member banks to hold reserves with the Federal Reserve or (since 1960) in vault cash, neither of which bears interest, the federal government imposed a tax on these banks and on their customers. When the reserve requirements were extended to all suppliers of third party transfers (checking accounts and equivalents) by the Depository Institutions Deregulation and Monetary Control Act of 1980, this tax was imposed generally (though still not evenly).[6] Since the Federal Reserve remits 90% of earnings on its investments in U.S. government obligations to the U.S. Treasury, in effect the tax is collected by the Treasury.

The Present Situation. Though regulation of and limitations on bank charters were instituted as a means of maximizing the amount of tax (direct and indirect) that could be imposed on banks and users of bank money, this type of regulation is no longer meaningful in the United States. Neither state nor federally chartered banks are required to invest in state or federal obligations or lend to the governments at favorable rates. But, by imposing reserve requirements on all providers of third party transfers, the Federal Reserve can and does impose a tax on users of bank money. Indeed, the amount of this tax and the efficiency with which it is collected is reduced by regulations other than reserve requirements that might be imposed on financial institutions. Limitations on charters or any other restrictions that impose costs on users of bank money reduce the value of this asset to users and, therefore, reduce the amount of tax that can be imposed. Therefore, assuming that a tax on users of bank money is desirable (an assumption that is questioned below), banking regulations other than reserve requirements on all money providers should be repealed.

Prevention of Centralized Power

The Historical Record. As noted above, the United States has a history of concern for and aversion toward centralized power. This concern was reflected in part by the refusal of Congress to renew the charter of the First Bank of the United States in 1811 and President Johnson's veto of the charter of the Second Bank of the United States in 1836. One argument against these banks was that they were too powerful (although many scholars believe that

[4] The Bank of England did not have a complete monopoly. A few, smaller banks of issue were permitted to operate outside of London and entry was essentially unlimited in Scotland.

[5] See Hugh Rockoff, "The Free Banking Era: A Reexamination," *Journal of Money, Credit and Banking*, VI, May 1974, 141-167.

[6] For estimates of the tax imposed, George J. Benston, *Federal Reserve Membership: Consequences, Costs, Benefits and Alternatives*, A Study Prepared for the Trustees of the Banking Research Fund of the Association of Reserve City Bankers, Chicago: 1978, Chapter III.

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FEDERAL REGULATION

the discipline imposed by the banks on their state chartered rivals was a more important reason for their demise.)[7]

The prohibitions against intrastate branch banking enacted by several of the states also may be considered to be a reflection of a basic bias against bigness. But the record does not support this as a general interpretation of branch banking legislation. While the branching activities of the Second Bank of the United States, in particular, were objected to by the state bankers with whom the Bank competed, by the end of the 19th century 20 states permitted branch banking. However, though the number of branches had increased somewhat from 1834 to 1900 (from 100 to 119), the increase in the number of banks over this period was so great (from 406 to 12,423) that the percentage of branches to banks declined from 24.5% to 0.0.[8] As the automobile increased mobility in the 1920s, branching increased steadily to 785 branches operated by 397 banks in 1915 to 3,005 branches operated by 724 banks in 1934.[9]

The increasing technological desirability of branching gave rise to two developments. One was the adoption of the McFadden-Pepper Act of 1927, which conceded to national banks limited power to branch in their home cities, subject to state legislation. (The home city restriction was removed in 1934.) The second was increased attempts by local bankers to have laws enacted that would restrain competition from larger banks. This often successful attempt linked branching with the underlying popular fear of centralized power. In this regard, an early observation by H. Parker Willis, the most influential U.S. banking academic of his time (or perhaps any time) is instructive and still pertinent. He states that the owners of small banks assert that branching ". . . would result in building up a money power which would crush the small banks out of existence. A more absurd reversal of the actual facts in the case could scarcely be imagined. What the establishment of branches would actually do would be to destroy the local money power which now practically stifles many forms of legitimate industry by a pressure of excessive interest rates, and by other even less justifiable means."[10]

Perhaps because the validity of Parker's remarks was recognized or possibly because the bankers in some states saw the advantages of branching, only a third of the states in the later 1920s prohibited banks from operating branches, a third permitted limited branching and a third allowed statewide branching. Presently, only 12 states prohibit branching, 15 allow limited branching and 23 statewide branching. Thus, a prohibition against branching neither was nor is the rule in the United States, and it is difficult to view the restrictions placed on this type of banking organization as a manifestation of a general fear of centralized power. Though the fact that interstate branching and nationwide banking has been prohibited argues in favor of the hypothesis that fear of large banks is a continuing feature of U.S. banking regulation, an alternative, or perhaps supplementary, explanation is that the restrictions have been based more on the local bankers' desire to protect themselves from competition. This is discussed below.

It also is important to distinguish the particular aspects of banking toward which the concern about centralized power was directed. Principally, centralization of the power to grant loans and make investments was the object of the founding fathers' fear. The centralization of note issuance also was important when bank notes were the most important circulating medium. Once demand deposit banking developed, there appeared to be relatively little concern about the centralization of this banking product. Nor was the centralized offering of collateral banking services ever considered much of an issue.

The Present Situation. Fear of centralized note issue is meaningful, but irrelevant for bank regulation; the Federal Reserve now controls or can control the money supply.[11]

Fear of the provision of centralized depository services has been stated as an important

[7] See Deane Carson and Paul H. Cootner, "The Structure of Competition in Commercial Banking in the United States," Research Study Two in *Private Financial Institutions*, Prepared for the Commission on Money and Credit, Englewood Cliffs, N.J.: Prentice-Hall, 1963, pp. 56-59. They give three reasons for the limited lives of the two federally-chartered banks: 1) Concerns by agrarian and small business borrowers with concentrated banking power; 2) sentiment for unit banking (the U.S. banks were establishing branches); and 3) desire for inflation (the U.S. banks were conservative note issuers).

[8] Carson and Cootner, p. 65.

[9] Ibid, p. 73.

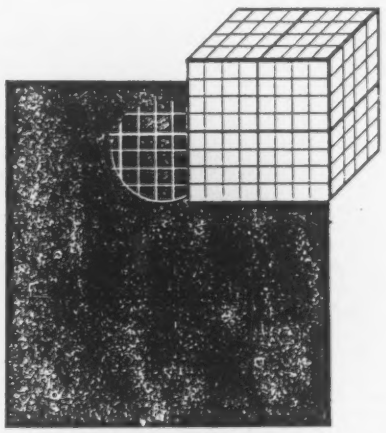
[10] H. Parker Willis, "The Demand for Centralized Banking," *Sound Currency*, Vol. 8 (March 1902), pp. 23-24.

[11] While there is reason to believe that this centralized power should be restrained, perhaps by repealing the legal tender laws and allowing alternative currencies and other means of payment to be used, the issue presently is moot.

issue by bankers who oppose intra- and interstate branching. Without these restrictions they assert that large branch banks would come to dominate the country and local communities. In large measure, their concern is based on the assumption that there are considerable economies of scale in banking operations, such that banking is akin to a natural monopoly. However, empirical studies have not found this to be the situation. Earlier studies (using data from the 1960s) found some economies of scale with respect to operating costs (with output defined as the number of accounts processed and average dollar size of accounts), but higher costs of branching. These effects were offsetting for larger branch banks.[12] A recent study that uses nationwide data for 1975 through 1978 found diseconomies of scale and very similar average costs for branch and unit banks when all variables were held constant (including the average size of accounts), except the numbers of accounts and branches. Most importantly for the present question, a small unit bank had slightly lower operating costs than a similar branch of a branch bank, all other things held constant.[13] Therefore, there is no reason to believe that smaller unit banks and small banks generally have a cost-disadvantage, such that they could not compete with large banks. Consistent with this conclusion is the experience in New York State when statewide branching was permitted and several New York City banks opened offices in out-of-city locations. They were unable to take much business away from the existing banks.

Because banking does not appear to be subject to economies of scale, the removal of restrictions on entry can only serve to decrease the centralization of banking services, particularly in local communities that are served by few banks.[14]

Loans to large and to many middle-sized borrowers, at the present time, are made nationwide, indeed world-wide, by banks. Loans and other sources of capital, such as direct and publicly placed bonds and equity shares, also are available from a very large number of nonbanking services. Thus most business borrowers can look to commercial banks in all states and in other countries, to insurance companies, to pension funds, to venture capital companies and to underwriters for short and long-term capital.



Trade credit is another source of funds for businesses. Government agencies also supply loans. Consumers can borrow from and through commercial banks, thrift institutions, mortgage bankers, consumer finance companies, sales finance companies, life insurance companies and retailers, among others.

Since enactment of the "Garn-St. Germain Depository Institutions Act of 1982," which removed most of the restrictions in thrift institutions' lending to business, the principal constraint on peoples' opportunities for obtaining financing from banks is the Glass-Steagall Act provisions. These prohibit commercial banks from underwriting and dealing in corporate bonds and equity securities and from investing in equities. Similarly, underwriters are forbid-

[12] For a review of these studies, see George J. Benston, "Economies of Scale in Banking," *Journal of Money, Credit and Banking*, 4 (May 1972), pp. 312-341, and George J. Benston, Gerald A. Hanweck and David H. Humphrey, "Operating Costs in Commercial Banks," *Economic Review* (Federal Reserve Bank of Atlanta), November 1982.

[13] George J. Benston, Gerald Hanweck, and David H. Humphrey, "Scale Economies in Banking: A Restructuring and Reinterpretation," *Journal of Money, Credit and Banking*, XIV, (November 1982).

[14] Even if banking were characterized by economies of scale, consumers still would benefit by the removal of organizational constraints as long as entry were unrestricted. In this event, should a bank drive out its competitors by underpricing them, it could not subsequently raise its charges without inviting in new competitors or reviving the old ones. Considering that there are few physical, capital or technological barriers to entry, predatory pricing would seem to be a foolish practice, but one that is beneficial to consumers if it is practiced.

FEDERAL REGULATION

den from offering depository services. Presently, this prohibition is supported by reference to fears of banks controlling loan and equity sources of funds. But were banks allowed to offer customers funds packaged as securities as well as loans, this would hardly result in a concentration of power, as long as the customers have the alternative of obtaining funds and services from insurance companies, pension funds, investment companies, underwriters and others. Another frequently expressed fear concerns the possibility of banks abusing their fiduciary responsibilities. In particular, they might use information gathered in the course of lending to trade in a corporation's equities. Or they might attempt to "bail out" of a bad loan by selling equities to the public, the proceeds of which would be used to repay the bank. If these fears were valid, though, they apply equally to underwriters, since they hold, buy and sell the corporate obligations. It also is important to note that though these fears presently are expressed, they were not given as argument for the Glass-Steagall Act. Rather, Senator Glass (who, prior to the bank failures that triggered the Act, had attempted to legally separate investment from commercial banking) believed as a matter of banking theory that the loans and investments of depository institutions should be limited to self-liquidity obligations (the real-bills doctrine.)

Restrictions on interstate banking and branching also limit, somewhat, the numbers of potential sources for loans for people living in less populated states and communities and in communities that straddle state borders. At the least, these restrictions tend to raise the price of loans to borrowers. Again, considering the multitude of sources for loans that are now available, there seems no reason to believe that any fear of centralized power can justify continuing these restrictions.

Avoidance of Competition

The Historical Record. Bankers are not unique in wanting to foreclose or limit competitors. As is discussed above, such limitations served the interests of monarchs and other governmental authorities and were the source of such regulations as restrictive chartering. In the United States, where, compared to Europe, many more banks were chartered, such restrictions on competition also took (and still take) the form of limiting or prohibiting branching. While these prohibitions often were (and still are) justified as a means of limiting centralized power, the reasoning and evidence given above is contrary to this rationale.

Limitations on the right of non-banks to offer banking services also were used to restrain competition. Until recently, thrift associations were prohibited from offering checking accounts to their customers. In most states they also were prohibited from offering consumer loans other than those related to real estate and a few types of specialty loans (such as education loans.) Nor could they offer checking accounts and loans to businesses. The prohibition against dealings with business were justified on the grounds of potential self-dealing by the officers of mutual associations and their charge to look to the needs of individual consumers. But these restrictions were maintained long after the thrift associations had changed from small, charitable institutions to large-scale lenders to real estate related enterprises as well as individuals.

Since banking was a regulated industry, the power of government also was used by the banks' competitors to constrain competition by banks (e.g., the Glass-Steagall Act which prohibits banks from offering securities underwriting services). Direct investments in companies not considered by the regulations to offer bank-like (congeneric) services also were prohibited. The argument for these constraints were couched in terms of concern for the safety and soundness of the banks or fear of centralized power by the banks. But the Glass-Steagall Act prohibitions were not based on empirical findings demonstrating that the provision of securities services by banks contributed to failures or to cheating of customers.[15] Rather, the evidence supports the belief that the investment bankers and underwriters were concerned about severe competition from banks and bank affiliates and sought (successfully in 1933) to eliminate these competitors.[16] Similarly, such businesses as travel agencies and computer service companies

[15] The most comprehensive work on the legislation lists the alleged abuses but does not cite any evidence of their occurrence. See W. Nelson Peach, *The Security Affiliates of National Banks*. Baltimore: The Johns Hopkins Press, 1941.

[16] Between 1927 and 1930, the participation of banks in bond issues grew from 36.8% to 61.2%. (Ibid., p. 110)

have sought to keep banks from providing services on the grounds that this would exceed the banks' legally granted powers. Thus regulation has worked both ways with respect to banks, though in either instance the cost was borne by customers.

The Present Situation. The desire and possibly the power of business people to restrain their competition is still with us. Commercial bankers do not want to face competition for business loans and deposits from thrift associations. Bankers who run small unit banks fear having to compete with the branch managers of large banks. Bankers in some states do not want to compete with bankers in neighboring or any other states. Brokers want to offer checking accounts but do not want bankers to offer brokerage services. And so forth.

But the ability of people in and at the periphery of the financial services industry to prevent others from competing for their customers is increasingly being eroded by technological change fueled by the opportunity cost of high nominal interest rates and the advantages of avoiding restrictive regulations. Three (of many) specific examples illustrate this situation:

- The transfer of funds by check first was offered by thrift institutions by means of negotiable orders of withdrawal and by credit unions with share drafts. Both forms of transfers look like checks, can be used as checks, but are legally not called checks. Better yet (for the consumer), interest is paid at the savings rate which, while constrained by Regulation Q, is still greater than the rate of zero permitted on regular demand deposits.
- Stock brokers offer their customers de facto checking accounts on which interest is paid at market rates. Furthermore, they are not constrained by geographic limitations, but operate nationwide. And they simultaneously can offer clients a wide range of investment alternatives, including direct ownership of stocks and bonds and participation in funds.
- Offices that solicit and service business and consumer loans are operated by major banks directly and as holding company affiliates in major cities throughout the country. Unregulated mortgage bankers and sales finance companies offer consumer loans throughout the country.

Thus the present set of regulations serve bankers who want to constrain competition primarily with respect to services provided on the local level, particularly deposit services where the depositor wants personally to deposit and withdraw funds. On the other hand, the regulations prevent bankers from organizing their operations in whatever way is most efficient for a given market and set of products and also prohibit them from directly offering a full range of services to their customers.

Bank Solvency and the Effects of Failures on the Economy

The Historical Record. Bank failures were not always considered to be horrendous occurrences to be avoided at all costs. All enterprises that involve risk may be sufficiently unsuccessful, poorly managed, fraudulently run or the victims of bad luck. Banks are no exception. And the record shows that banks regularly failed throughout history. Many of the more spectacular bank failures were due to overly rapacious taxation by monarchs and other government officials. In these cases, regulation served to increase the ability of the rulers to over-use their power to the detriment of the banks' other customers, owners and employees, and often of the state. While it is true that many banks failed because their operators acted incompetently or fraudulently, it appears that failures were more often the consequence of governmental interference or incompetence.

The experience of the United States, which (together with Scotland) was one of the few countries that permitted competitive banking, is particularly instructive.[17] Prior to 1837, bank charters had to be obtained by special acts of the state legislatures. In part to avoid the corruption that tended to accompany the granting of these quasi-monopolies, and in part because of the public demand for more banking facilities and a sentiment toward unrestricted enterprise, Michigan in 1837 and New York and Georgia in 1838 enacted free bank chartering laws. These laws permitted anyone to open a bank who provided a minimum amount of capital and deposited with a state agent a specified amount of bonds that could be sold to repay the holders of bank notes (which served as hand-to-hand cur-

[17] The Scottish experience is one of stable banking, much more so than the experience of England with its central bank and restrictions on entry and competition.

224

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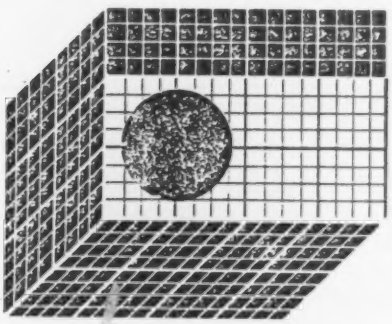
FEDERAL REGULATION



rency) should the bank fail to redeem the notes as promised. By 1860, 18 of the 32 states had passed such laws (Michigan twice.)[18]

Because some of the state laws were drawn so as to permit the bankers to issue notes with face values in excess of the market values of the bonds, and because the public was led to believe that the bonds provided adequate security for the notes, "wildcat" banking was profitable in some of the states. Wildcat banking occurs when bankers issue many more notes than they can redeem and, if the notes stay in circulation long enough (whence the term, wildcat banking, which refers to establishing redemption offices in areas populated primarily by wildcats), the issuers can profit even if they later become bankrupt. In these states, there were many bank failures. Michigan, in particular suffered such a rash of failures (the typical life span of a free bank was no more than six months) that the legislature suspended the law after about a year, in April 1838. The reason for this bad experience was that the notes issued by the Michigan banks did not have to be redeemed in specie and could be backed by mortgages. Consequently, Rockoff explains, people would "create a mortgage on a worthless piece of property, have it certified as being valuable by some friends, and then transfer it to a wildcat bank in exchange for a mass of bank notes. . . . Other [currency issues] were simply frauds which operated in violation of the free banking law."[19]

Nevertheless, the losses suffered by the public as a consequence of holding worthless or depreciated bank notes were not great. Including the $1 million lost by holders of Michigan bank notes and $394,700 lost in the first years of New York free banking (after which losses were negligible), estimated losses in the 18 states through 1860 totaled only $1,852,900, or less than 2% of the money stock.[20] Indeed, despite its bad experience, Michigan reinstated free banking in 1857. On the other side of the ledger, free banking resulted in increased banking services and lower profits to banks (and, hence, lower costs to consumers). Furthermore, private regulatory arrangements, such as the Suffolk system in Boston and the New York clearinghouse, virtually eliminated the member banks' failures to redeem their notes for specie.

The national banking system, created in 1863, represented a continuation of free banking, since entrepreneurs were able to obtain bank charters without having to get special bills passed by state legislatures. However, they did have to put up more capital than was generally required for state charters, maintain specified reserves against their deposits, and could issue bank notes only in amounts that did not exceed the lesser of 90% of the market value or 100% of the par value of registered U.S. bonds which had to be deposited with the U.S. Treasurer. Even then there were many bank failures for reasons which included actions by the U.S. Treasury that reduced the amount of bonds available for backing note issues, and a prohibition of branch banking that was not relaxed somewhat until 1927.

Even after 1927 (indeed to this day) banks are restricted from branching within many states and across state lines by state-enacted laws. These laws restrain banks from efficiently diversifying their operations geographically. Hence, they are more liable to local and area economic failures and depressions. This is borne out by the data, which show that from 1921 through 1931, when 8,916 banks were suspended, only seven were banks with more than ten branches; of these, only three operated branches outside the city of the head office.[21] It should be noted, however, that permission to branch intra-state is unlikely to have benefited most of the banks

[18] See Rockoff, op. cit., from which this account is drawn.
[19] Ibid., p. 146.
[20] Ibid., pp. 150-151.
[21] George J. Benston, "Bank Examination," *The Bulletin* of the Institute of Finance, Graduate School of Business Administration, New York University, Numbers 89-90, May 1973, Table II p. 12.

that failed. As is described further below, the largest group of failures were among small banks in agricultural states. But, had interstate branching been permitted, these banks could have diversified sufficiently, as did the Canadian banks, where nationwide banking was permitted and only one bank (in 1923) failed.

The data on bank suspensions since about the turn of the century might, by contemporary standards, appear descriptive of a total banking collapse. Between 1890 and 1899, 1084 banks were suspended, 1789 were suspended between 1900 and 1920, and 5712 between 1921 and 1929.[22] Expressed as annual percentages of active banks, the suspensions in each of the periods are 1.50%, .34% and 2.30%. As annual percentages of the deposits of active banks the deposits of the suspended banks are .10% for the 1900-1920 period and .42% for the 1921-1929 period. And in the period of the largest number of suspensions, 1921-1929, the average annual losses borne by depositors as a percentage of deposits are only .15%. Thus, in the decade before the debacle of the Great Depression, the losses to depositors were not very great. Perhaps this is the reason that, despite the large number of suspensions, there were no successful moves to "reform" the system. Nor did the bank suspensions adversely affect the economy in general. In fact the overall growth of the economy was particularly great in the 1920s, the period of the greatest number of suspensions. To the contrary, the principal cause of the suspensions appears to have been adverse local economic conditions, particularly those in the agricultural regions of the western grain states (where 47% of the suspensions during 1921-1929 occurred) and of the southeastern and southwestern states (with 18% and 11% of the suspensions).

The Great Depression saw 9096 bank suspensions between 1930 and 1933. These are 11.29% per year of the active banks; they held 4.14% of the deposits. Between 1930 and 1933 the average annual losses borne by depositors as a percentage of deposits averaged .81%, 5.4 times the loss rate of .15% experienced in the 1920s. While the great number of bank failures undoubtedly affected the economy negatively, most scholars agree that the banks were primarily the victims rather than the cause of the Great Depression.[23]

However, it should be noted that bank runs played an important role in the Great Depression and in previous financial collapses. "Black Thursday" 1873 saw the failure of Jay Cooke's banking house and the first closing of the New York Stock Exchange. It was followed (perhaps causally) by six years of depression. The failure in 1884 of former President Grant's firm, Grant & Ward, and of the Marine National Bank sparked runs and the consequent failure of numerous banks and brokerage houses. The Panic of 1893 was touched off by the 1890 failure of the London banking firm of Baring Brothers, which specialized in financing U.S. enterprises. Baring's European creditors demanded that American pay their debts in gold. As a consequence, the base money supply was depleted and a multiple contraction resulted, and 1891 saw a mini-panic. During the following 1893 panic over 600 banks and 13 of every 1,000 businesses failed in perhaps the second deepest depression (after the depression of 1837) in the nation's history before 1930. The New York Clearing House suspended convertibility to specie, which ended the run. The situation also was helped by J. P. Morgan's negotiation of a sale in Europe of a $100 million U.S. bond issue. Panic struck again in 1907 when New York City and several corporations were unable to sell high yielding bond issues. The Knickerbocker Trust Company failed (largely as a consequence of speculation with depositors' funds) and several major banks experienced severe runs. Again, the New York Clearing House suspended convertibility to specie and J. P. Morgan later helped increase reserves with European loans and U.S. Treasury deposits.

The creation of the Federal Reserve in 1913 was supposed to rid the country of these recurring collapses. As the lender of last resort, with great resources and the power of the printing press, it should have been able to better the

[22] Ibid., Table II, p. 12.

[23] Clark Warburton carefully studied the relationship between bank failures by county and the 1930s depression. He concludes: "There was a massive contraction of deposits nationally, during the early 1930s, relative to the rate of growth during the 1920s, of which less than one-fourth was accounted for by deposits in suspended banks. This indicated that the depression of the 1930s could not be explained by the impact of balances of payment resulting from adverse conditions in particular industries or areas, but was due to, or at least associated with, some potent force operating on a national scale." (*Depression, Inflation and Monetary Policy, Selected Papers, 1945-1953*, The Johns Hopkins Press, Baltimore, MD: 1966, p. 21.

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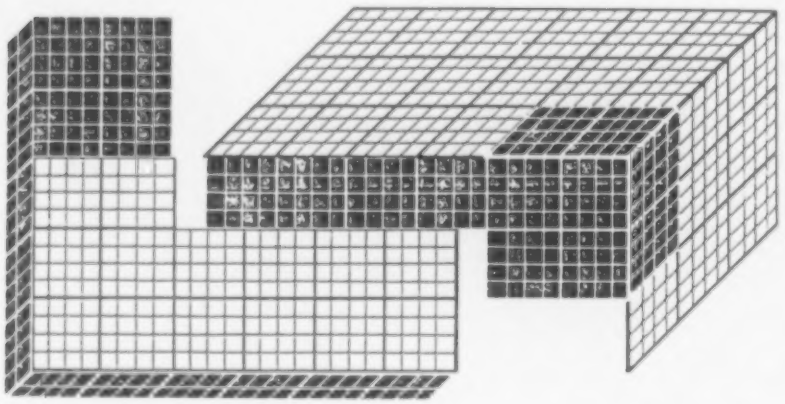
FEDERAL REGULATION



New York Clearing House's and J. P. Morgan's record. But, when the Bank of the United States collapsed in 1930, runs were made on other banks. And the Fed did not prevent the collapse of a third of the banks during the next several years. Though the losses to depositors and others as a consequence of the panics that preceded the Federal Reserve were considerable, the costs absorbed by the public after the creation of the central bank appear to be greater. The sharp and relatively short depressions of 1837, 1873, 1893 and 1907 should be compared with the Great Depression of the 1930s. The recession of 1920-21 should be contrasted with the sharper recession of 1937-38 (when the Fed doubled the required reserves ratios) and the relatively small post World War II recessions, and the present recession. And the cost of losses in purchasing power absorbed by depositors because of the non-war time inflations of 1916-17 and the 1970s to the present should be compared to the losses depositors took because of bank failures at all times, including the 1930s. The record may not give one faith in regulation by a central bank as a means of protecting depositors and maintaining the solvency of the banking system and the economic well-being of the nation.

The creation of the Federal Deposit Insurance Corporation in 1933 was a salutatory innovation. Since most depositors no longer need fear that their funds will be lost should a bank fail, runs have largely become a relic of the past. The word "largely" is used because uninsured depositors (those with over $100,000 in an account) have reason to fear loss of their funds, particularly if the FDIC closes the bank rather than arranges for its assumption by another bank. Furthermore, the event of a bank failure gives large depositors reason to question the safety of their funds in other banks where the assets held and operating procedures appear to be similar to those of the failed bank. For example, when the Penn Square and Abilene National banks failed in 1982, other banks faced the problem of convincing depositors that their funds were safe. However, the snowballing effect of pre-FDIC runs did not occur. Nor did banks that were unconnected to the failed banks experience difficulties.[24]

The question to be considered, then, is whether bank failures or even the possibility of limited bank runs are presently a matter for concern more than the failure of any non-regulated enterprise.

The Present Situation. With the possibility of a bank failure causing runs on other banks largely a concern of the past, and with protection of bank note holders no longer meaningful since the currency is provided and guaranteed by the Federal Reserve, what reasons can be adduced

[24] An exception is the small run on the Franklin Savings Bank when the Franklin National Bank (an unrelated institution) failed.

for governmental concern about the solvency of banks? This question can be answered by considering the costs to the principal persons who would be affected by a bank failure: Owners, employees, borrowers, depositors and users of other banking services.

The owners (stock and bondholders) clearly are hurt by failures. But their position is no different than that of the owners of other enterprises. In fact, because banks use little if any specialized assets, the owners tend to lose less than had they owned the shares of most other types of businesses. Mutual banking organizations—mutual savings banks, savings and loan associations and credit unions—are an important exception. The mutual form was adopted for these institutions because they began as charitable or fraternal, non-profit organizations. Most of them are constrained by competition in the market place to operate as efficiently as do stockholder-owned institutions. But, unlike the situation for stockholder-owned enterprises, monitoring by stockholders and the securities market is not present. Consequently, should a mutual institution be operated inefficiently or fraudulently, there is a need for a supervisory government agency to step in to protect the equity in the assets that, in effect, belong to the community.

Employees of banks also would be adversely affected by the failure of their employers. But, because so many banks operate similarly, bank employees have skills that are readily transferable, unlike the employees of most other enterprises. In addition, a failed bank is likely to be absorbed into another bank rather than dissolved. Hence bank employees are less in need of governmental concern than are other workers.

Borrowers would lose the value of their contacts with the officers of a failed bank and the officers' knowledge of them. But if the failed bank is taken over by another organization, the cost is likely to be small. Depositors whose accounts are fully insured suffer, at most, a short delay and some inconvenience until their accounts are paid off or transferred to another bank. Uninsured depositors might lose. But since they are holders of large accounts (currently over $100,000), it seems likely that they are capable of assessing the risks and obtaining sufficient compensation, *ex ante*, for the risks. In any event, the historical record suggests that the expected losses are relatively small. Nor are the users of other bank services likely to be seriously inconvenienced, since if entry were not restrained by regulation, there are likely to be many competing sources of services available.

This leaves only the owners and others associated with banks that might experience runs because an apparently similar bank failed. To the extent that these banks are misperceived as offering greater risks to uninsured depositors, they will bear unfairly imposed costs. But the possibility of runs also gives banks a salutary incentive to conduct their affairs such as to engender confidence among their large depositors. The complete removal of this concern by depositors and of the banks about depositors' fears is likely to lead to greater than optimal risk-taking by banks. In the following section, some changes in the present institutional arrangements are suggested that should lead to a better balance between these conflicting concerns.

To summarize, in today's environment with FDIC insurance, the effect of a failure of a bank on employees and customers (and hence on communities) and even on owners is likely to be less than for most other types of enterprises. With bank runs virtually not a problem, the possibility of failure is no longer a valid reason to subject banks to special regulations other than deposit insurance requirements. (The interests of the deposit insurance agency and of the banks with respect to deposit insurance are considered next.) Indeed, there is reason to believe that many of the regulations imposed on banking increase the possibility of failure. In particular, regulations restricting branching reduce the banks' ability to diversify their deposits geographically. Restrictions on the types and maturities of the products that they can offer their customers similarly restrict their ability to diversify their portfolios. (Witness the current situation of thrift institutions because of past regulations.) Hence, they are more vulnerable to unexpected changes in local economies, the fortunes of specific industries (e.g., housing), and interest rates. The regulations also reduce the alternatives available to customers should a bank fail. Therefore, if concern for bank failures is an important issue, these restrictive regulations should be removed. The only supervising

FEDERAL REGULATION

function that might be justified from a concern with failures is the ultimate supervision of mutual institutions.

Deposit Insurance

The Historical Record. Federal deposit insurance, established 1933, came about as a consequence of the very large number of bank failures of the early 1930s. These were primarily the consequence of the joint effect of a major sustained decline in the money supply and the U.S.'s fractionalized banking system, where inter-state branching was not allowed and many states prohibited or restricted branching.[25] Consequently, the portfolios of a large number of banks were not diversified geographically or across many types of businesses. Hence, they were inordinately subject to the effects of local economic collapses and to a rapid decline in the money supply. The banks in other countries did not suffer similar failures because they were able to meet deposit drains with funds drawn from other areas. While the U.S. banks had established relationships with other banks from whom, presumably, they could borrow funds, these express or implied contracts apparently did not hold up in the generally adverse conditions of the early 1930s.[26]

Following the collapse between 1930 and 1933 of 9,096 commercial banks (36.4% of those operating in 1929), 526 savings and loan associations (4.4% of the total in 1930), and 10 mutual savings banks (1.7% of the number in 1930), some reform was politically, if not economically, necessary. The smaller unit banks opposed branch banking and, considering that in 1930-31 93% of the suspended banks had total loans and investments of under $2,000,000 (70% were under $500,000), they reasonably feared both gradually lost deposits and runs as depositors sought the safety of larger banks. The large banks wanted to eliminate the payment of interest on demand deposits, since they had been unable to sustain repeated agreements to limit competition among themselves for the deposits of correspondent banks and large non-bank depositors.[27] The apparently politically acceptable compromise was a liberalization of the branch-limiting McFadden Act to permit national banks to branch to the extent that state banks could branch (but not permission to branch regardless of state law either within states or nationally), the legal prohibition of interest payments on demand deposits, and the establishment of the Federal Deposit Insurance Corporation. Although the FDIC insured individual deposit accounts only to a maximum of $2,500 (raised the next year to $5,000), assessments were imposed on a bank's total deposits. Thus the larger banks, that held largely uninsured deposit accounts, subsidized the small banks. But as Carter Golembe estimated, this cost was almost exactly offset by their savings of interest payments on demand deposits.[28]

Federal deposit insurance not only has benefited smaller and particularly unit banks, it has made bank runs no longer a serious problem. Banks are unlike all other enterprises in being subject to the externality of runs. For example, if someone is a bondholder of General Motors Corp. and believes that the company has or is about to absorb large losses, the best that person can do is sell the bond to someone else before the buyer learns of the bad news. The bondholder cannot successfully get General Motors to repay the bond until it is legally due. But if someone is a demand depositor in a bank and believes that the bank is in financial difficulties, funds can be removed by the person simply by writing a check or personally making a withdrawal. Since a rapid withdrawal of funds by depositors may force the bank to sell assets at distress prices or borrow at high rates, this may result in losses that exceed the stockholders' investment, losses that will have to be absorbed by the remaining depositors. Therefore, even if the bank is paying depositors interest that compensates them for the risk they take, the depositors are well-advised to remove their funds if the probability of a failure times the deposit balance exceeds the cost of making another banking arrangement plus any interest

[25] Note Warburton's study referenced above, the concentration of suspensions among small banks (noted below), particularly those in the agricultural areas, and the very few failures of branch banks noted above.

[26] The only important exception is the mutual savings banks. Apparently because of a fraternity derived from shared mutualism, they provided each other with the currency needed to pay off anxious depositors and, then, stem incipient runs. They also benefited from not practicing reserve banking and from their concentration in long-maturity assets, the present values of which increased when interest rates declined unexpectedly.

[27] See Carter Golembe, "Memorandum re: Interest on Demand Deposits," Carter H. Golembe Associates, Inc., Volume 1975-10 for an excellent review of the legislative maneuvering.

[28] Ibid., p. 7.

that might be foregone if it were credited on a delayed basis. With deposit insurance, those depositors whose balances do not exceed the insured amount need not fear a bank failure. While depositors with uninsured balances face potential losses should the bank fail, they need not fear a panic by the presumably uninformed holders of smaller accounts. Furthermore, depositors' experience with the FDIC gives them reason to believe that the deposit liabilities of most banks (especially very large ones) will be assumed by other banks without loss to the depositors. Hence, while they are not completely shielded from loss, the risk is very small and the incentive for panic withdrawals is concomitantly small.

But because federal deposit insurance saves insured depositors (and, to a large extent, uninsured depositors, as well) the cost of learning about the operation of banks, it also serves to free the banks from the discipline of those depositors' concerns. In this situation, the banker has an incentive to put the depositors' funds into risky assets. Should the events turn out well, the banks' stockholders reap the benefits. Should events turn out badly, the FDIC pays off the depositors. While the stockholders also are likely to lose their investments, in the absence of a sufficient risk premium or other costs imposed by the FDIC, the expected gains from risk-taking exceed the expected losses.[29]

Previous (prior to the FDIC) U.S. history bears out this expectation and also provides lessons that should be useful today. Prior to the National Banking Act of 1863, deposit guarantee systems were established in New York (1828), Vermont (1831), Indiana (1834), Ohio (1845) and Iowa (1858).[30] The New York and Vermont systems were state run and the others were based on mutual agreements among the participating banks. Their systems operated successfully, largely because they included the authority of the plan officials to monitor operations of the participating banks and control excessive risk-taking.[31] A second wave of deposit guarantee plans for state banks occurred after 1908. With one exception (Mississippi), the plans did not include effective supervision and they failed. These included the compulsory plans of Oklahoma (1908), Nebraska (1909) and South Dakota (1916) and the voluntary plans of Kansas (1909), Texas (1910) and Washington (1917). Since depositors were told that their money was safe, there was a great incentive for unscrupulous operators to take excessive risks. Indeed, the record shows greater failure rates of guaranteed banks than among similar non-guaranteed banks operating in the same areas. The Mississippi plan (1915), which included supervision and bank examinations, continued until 1930.

Thus a cost of deposit guarantee represents effective supervision by the insurance company or other authorities and/or the charging of risk-adjusted rates. While fees that reflect the risk could be charged by the FDIC, Federal Savings and Loan Insurance Corporation (FSLIC) and National Credit Union Share Insurance Fund (NCUSIF), they have opted instead to impose costs in the form of on-site examinations on the insured institutions. When the operations of the institutions are considered to be unsafe, the institutions are subjected to more frequent and more extensive examinations. The cost of these examinations include per diem fees (levied by some agencies) and the cost of disruption. Restrictions on the institution's right to expand and required infusions of capital also are imposed. More severe penalties include cease and desist orders, the removal of the institution's officers and its closing or merger with another institution. The extent to which these costs exceed the benefits from deposit guarantees and alternatives to the present system are considered next.

The Present Situation. Given the past history of bank runs together with the fractionalized banking system that makes stopping runs difficult, it appears to be necessary to continue deposit insurance. It is possible that the necessity for mandatory deposit insurance would be obviated if the Federal Reserve could be counted on to provide the reserves required to offset runs and if the removal of regulations made it possible for banks to offer depositors an acceptable mix of interest payments, diversified

[29] If entry into banking is not constrained (as is suggested in this paper), the gains to shareholders from risk-taking will be greater, *ceteris paribus*, since they will no longer face the loss of rent from restricted entry.

[30] This narrative is derived from George J. Benston "Bank Examination," *The Bulletin*, Institute of Finance, Graduate School of Business Administration, New York University, Nos. 89-99, May 1973, pp. 50-52.

[31] However, it should be noted that the New York state system was phased out as bank charters were granted and renewed under the free entry banking law. As banks left the insurance system, the premiums were not consequently

230
JBR

portfolios and private insurance. But considering the almost universal expectation by depositors with smaller account balances that they need not acquire information about the riskiness and management of bank assets, continuation of deposit insurance appears to be unavoidable. Also, considering the cost to these borrowers of assessing risks, an insurance system would seem to be cost effective.

The present system though suffers from three important defects. One is that the procedure of charging depository institutions a flat-fee against their total deposit liabilities gives the institutions an incentive to hold riskier assets. At the same time, the insurance agencies (FDIC, FSLIC and NCUSIF) have a complementary incentive to over-regulate the institutions, since the agencies lose should a failure occur but do not garner the gains from a risk taken. There is no reason to believe that the outcome is reasonably close to optimal, particularly with the respect to the efficient allocation of capital. Second, bank runs still can be a problem, since uninsured depositors have a considerable incentive to remove their funds if they believe a bank will fail and not be assumed. Probably because of this expectation, very large banks (which hold relatively large amounts of uninsured deposits) have been loaned large sums of money by the Federal Reserve to keep them from failing and, when they failed, assumptions rather than payments were arranged by the FDIC. Consequently, depositors in such banks are, de facto, 100% insured and they no longer serve as monitors of the banks' activities. Collaterally, banks that are thought to be subjected to the payout procedure are placed at a competitive disadvantage. Third, the methods of examination and supervision employed by the agencies are unlikely to be efficient, since each is in a monopoly position with respect to its institutions: e.g., national banks cannot elect to be examined by the FDIC rather than by the Comptroller of the Currency. Although the agencies have made some attempts to improve their supervisory methods in recent years, Flannery and Guttentag (among others) find the techniques used to "fall well short of the state of art."[32] As long as the agencies have a clientel that has no alternatives, they need not be too concerned with the costs of inefficient examinations and over-supervision.

The flat fee compared to variable-risk-fee defect could be corrected by requiring the insurance agencies to charge risk-related fees. One might ask, though, why they have failed to adopt this procedure, even though it has been suggested by most writers on the subject and is used by most private companies. The answers might be that the assessment of banking risk is too difficult, would engage the agencies in too great an involvement in banking activities (since risk-related fees have the effect of directing a banks' allocation of resources), or that there presently is no incentive for the agencies to change established procedures. While there is some validity in each explanation, I prefer the last, which implies that unless the present legal arrangements are altered, the flat-fee system will remain.

The remaining possibility of bank runs could be eliminated and the monitoring by depositors enhanced by the following change. All deposits transferable on demand (including savings deposits for which the 30 day waiting period is almost never invoked) would be completely insured. But all time deposits over, say, $10,000, would not be insured at all unless a bank wished to purchase the insurance. Under this regime, runs could not occur because the time deposits could not be withdrawn until maturity. But, if a bank was thought to be operated in a manner that might result in a failure, the expectation would be reflected in the interest rates it would have to offer on its time deposits and certificates.

Finally, the defects of inefficient examination and supervision and the charging of inappropriate insurance fees can be cured, or at least reduced, by introducing competition among insurers for the business of financial institutions. Competition can be introduced first by permitting any depository institution to be insured by any of the three federal agencies. The agencies would be permitted to levy the types (e.g., variable rates) and levels of charges and monitoring mechanisms (e.g., examinations) that they felt desirable and the institutions could switch among the agencies much as any person can choose insurance companies. Then, to introduce even more competition into the market for de-

[32] Mark J. Flannery and Jack M. Guttentag, "Problem Banks: Examination, Identification and Supervision," in *State and Federal Regulation of Commercial Banks*, Leonard Lapidus and Others, Federal Deposit Insurance Corporation, 1980, Vol. II, p. 215.

posit insurance, depository institutions should be permitted to purchase insurance from private companies or from other banks, as long as these companies and banks were approved by the chartering agency (about which more is said below). The private insurance can be in place of or supplementary to government agency insurance. So that the public is not misinformed, the depository institutions would have to prominently state the insurer they use, much as they now must state "Member Federal Deposit Insurance Corporation."

One should consider the concern that competition among insurers might lead to "agency shopping" by badly or fraudulently run banks wanting to escape regulation. Two factors argue against this possibility. One is the evidence of switches in bank charters. During the years 1960 to 1966, when Comptroller of the Currency James Saxon liberalized regulations, state banks had an incentive to convert to national charters. In the years since the late 1960s, when the opportunity cost of required reserves increased considerably, banks had an incentive to switch to non-member bank status. But the number of state banks adopting National charters from 1960 through 1977 relative to the number at year end 1977 was only 5.9%. In the same 18 year period, 6.3% of the national banks became nonmembers.[33] A detailed study of these (and other) changes revealed that "some, but not many, bankers abuse the forum shopping principle of choice."[34] The second, more important factor, is that a depository institution cannot change to another insurer unless that insurer accepts the institution. Since the insurer bears the cost of a failure, it has a strong incentive to refuse to accept institutions that are badly or fraudulently run.

Control of the Money Supply

Even those economists who do not declare that control of the supply of money is essential believe it to be desirable. The Federal Reserve can effect this control in several ways. As is the procedure in many countries, the central bank could issue and withdraw legal tender by buying and selling securities (open market operations) and by printing currency. The demand deposits (which hereafter includes such close substitutes as NOW accounts) portion of the money supply then could be controlled via the substitution by money users of currency for deposits and vice versa. The principal problems with this procedure are that demand deposits comprise the bulk of the money supply, the link between deposits and currency is inexact, and there are real resource costs in not permitting the public to have the amount of currency required for day-to-day transactions. Most of these problems can be avoided by using required reserves against demand deposits to control the money supply. The central bank can determine the amount of reserves that banks (hereafter denoting all suppliers of demand deposits) hold with one or a combination of three methods: Adjusting the required reserve ratio, open market operations and/or controlling borrowing from the central bank. Changes in reserves that result from changes in float, foreign transactions, Treasury operations, shifts among deposits against which different reserve ratios are required (if this practice is followed), and changes in the banks' and the public's desired holdings of excess reserves and currency can be offset with open market operations.

For the effective control of the money supply via reserves, the central bank must have information on the banks' reserve balances and be reasonably assured that the relationship between the reserves and the money supply is stable or, at least, predictable; e.g., there will not be unexpected shifts of deposits for money substitutes that it cannot effectively offset. For this purpose it is desirable (but not necessary) that the providers of demand deposits be subject to specified reserve requirements and that they be known to and possibly report to the Federal Reserve. (Reporting would not be necessary if the Fed could adequately estimate the needed data with sampling.)

Monetary policy would be more effective if velocity were more predictable. For this reason, and as an aid to identifying the assets that are used by the public as money, it would be desirable if the opportunity value to non-banks of providing money substitutes were minimized. For these purposes (and for reasons of equity

[33] Randall J. Miller, "An Analysis of Chartering and Conversion, 1960-1977," in *State and Federal Regulation of Commercial Banking*, Leonard Lapidus and others, Federal [illegible] Corporation, Washington, D.C., 1980. Volume II, [illegible]

[34] [illegible] p. 462

FEDERAL REGULATION

and the efficient allocation of resources), bank-provided money should not be taxed at a higher rate than other forms of money. This leads to the conclusion that the Federal Reserve should pay interest on the required reserves it holds against demand deposits. The rate of interest should offset the opportunity loss to the banks of the funds required to be held as reserves. With no other regulations imposed on banks (other than required deposit insurance) competition would ensure that the demand depositors rather than the banks would benefit from the removal of this tax on their funds. While the govenment would lose this source of revenue, the public would gain from the Federal Reserve's more effective control of the money supply and from a more efficient allocation of resources. At the same time, tax subsidies to banks should be removed, such as their right to earn tax free interest on state and municipal bonds while being allowed to deduct against taxable income the cost of funds used to purchase the bonds.

The Furtherance of Social Goals—The Provision of Banking Services

Three general types of social goals are distinguished: 1) The provision of the banking services of loans, fund transfers and savings; 2) support of housing and other attempts to allocate credit; and 3) prevention of individual discrimination and unfair dealing against individuals. Each is described and analyzed individually in the following sections.

The Historical Record. Until recently, commercial banks were expected to further social welfare primarily by providing businesses and consumers with an efficient means of making transactions (bank notes and checking) and borrowing and lending assets (loans and savings). The banks also served as a vehicle for collecting taxes (as is discussed above). The additional goal of unrestricted access to these facilities was characteristic of the United States. Hence a powerful, national quasi-monopoly bank, such as the Bank of England, was not permitted to develop until the Federal Reserve was created in 1913; and, for most of the nation's history, bank charters were not difficult to obtain.

It is important to note that the Federal Reserve was not conceived of as a central bank, but as a bank for and by bankers. Its function was to facilitate check clearing and provide other banking services for its members. After it was converted into a central bank by Senator Glass and President Wilson, a principal social purpose still was the development of an efficient nationwide clearing system as well as a vehicle for eliminating panics and providing the nation with an "elastic" currency. The cost of the system was borne by the members with the non-interest bearing reserves they were required to keep at the Federal Reserve Banks. With the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, the Fed was directed to charge users of its services for the full cost of those services. By this action, the social desirability of publicly supporting a national payments system was recognized as being no longer a concern of the present.

The United States developed specialized financial institutions in large measure to serve perceived social goals. Mutual savings banks (MSBs) were established (the first in 1816) for the social purpose of providing a place where the working poor could save with safety.[23] These institutions were founded as mutuals because the costs of providing these services exceeded the revenues derived therefrom: hence space and personal services often were donated and the institutions were not taxed. The MSBs were established primarily in the northeast, where they dominated the market for savings. They did not develop much in other areas of the country, for two reasons. One is that the mutual form of organization made establishment of a new bank difficult, particularly when the charitable desire to help the poor in this way was not as strong as it was in the northeast. The second is the newly-established banks in the other, newer states were not averse to serving the less affluent individuals shunned by the well-established northeastern banks. Because their principal stated goal was service to the working poor, and as a consequence of some failures during the panic of 1873, the MSBs were legally prohibited from investing these peoples' savings in such risky and potentially fraudulent assets as business loans. Consequently, they tended to

[23] See George J. Benston, "Savings Banking and the Public Interest," *The Journal of Money, Credit and Banking*, IV, Part II (February 1972), Chapter II.

hold bonds. By 1910, though, about half of their portfolios were in mortgages. The percentage declined after the 1930s and did not get up to about 60% to 70% until the 1960s.

Savings and Loan Associations (S&Ls) were established principally to make mortgage loans. They developed from mutual building and loan societies. In the early years of the Great Depression federal chartering of mutual S&Ls was established with the goal of helping the housing industry recover. Thus, although the financial statements of the S&Ls and MSBs now look very similar, they were initially established to serve different social goals.

Consumer finance companies and credit unions also were established for a social purpose. Consumer finance companies were licensed by states (the first in 1916) to make small loans at gross rates that greatly exceeded the states' usury ceilings. The small loan laws were passed when it became clear that the urban population was prevented by the usury statutes from obtaining loans legally; those who were unable to borrow from friends and relatives had to turn to loan sharks. Credit unions similarly were established to provide a source of small loans to individuals. Churches, fraternal groups and businesses supported their development with donations of space and labor, since they made loans to members of these groups. Their growth also was helped by exemption from taxation.

The Present Situation. The laws and regulations that first forbade and now constrain thrift associations from serving their clients have had a negative social impact. As consumers' demands changed from wanting a safe haven for savings and for mortgage loans to also wanting a wide range of financial services (particularly checking accounts and consumer loans), the institutions should have been free to offer the products demanded. Furthermore, the institutions were prevented from offering business loans and other services that would have benefited their communities. Similarly, restraints on commercial banks (e.g., the Glass-Steagall Act) that prevent them from offering a full range of services and geographical constraints in the form of prohibitions against intra- and inter-state branching have kept them from meeting the social goal of service to consumers. Laws that limit payments to savers—the prohibition of interest on demand deposits and Regulation Q—obviously are contrary to the social goal of not hurting consumers, particularly since these limitations affect mostly the depositors who are ignorant of such alternatives as money market funds or who hold balances that do not meet the funds' minimum requirements. Indeed, it is difficult to find any of the laws and regulations that prohibit or constrain banks or any enterprises from offering their services to the public as operating to further social goals as these usually are expressed. While these constraints may have been imposed to reduce the incidence of bank failure (although that motivation and the effectiveness of the laws and regulations for that purpose are very doubtful in many instances), the advent of deposit guarantees should have eliminated this concern.

The continued provision of payments clearance and other banking services by the Federal Reserve also is no longer relevant for advancing the social concern of improved banking services. Alternative and supplementary services have been offered by non-government organizations for some time. Now that all depository institutions that offer third-party transfers are required to maintain reserves with the Federal Reserve Banks and all can obtain Federal Reserve services at a price, there seems no reason for these services to be provided by a government agency. Rather, this aspect of the Federal Reserves' operations should be split off into a separate corporation. A method for achieving this transformation is offered in the last section of the paper.

Support of Housing and Other Attempts to Allocate Credit as Social Goals.

The Historical Record. Housing was adopted as a social goal in the 1930s, when federal chartering of S&Ls and federal guarantees of home mortgage loans were established. This goal was furthered by the creation of the Federal Home Loan Bank Board as a regulatory agency, and the Federal Home Loan Banks, the Government National Mortgage Association and the Federal Savings and Loan Insurance Corporation as vehicles for diverting funds into home mortgages. The extension of Regulation Q ceilings to thrift associations in 1966 and their continuation at a level below market rates on the savings deposits

234
USH

of all insured depository institutions were justified as means of keeping funds flowing into mortgages. Other means of supporting home ownership were restrictions on the non-mortgage assets in which thrift institutions can invest and the granting of tax benefits if mortgages are above a given percentage of total assets. Most recently, the Home Mortgage Disclosure Act of 1975 and the Community Reinvestment Act of 1977 were enacted to encourage (or force) chartered financial institutions located in older urban areas to make mortgage and other loans in those areas. The former Act is simply a disclosure statute that requires the institutions to identify publicly the volume and type of mortgages made by census tract. The Community Reinvestment Act requires institutions to demonstrate they have adequately served their local communities, particularly when they request permission to open or close branches.

Other attempts to allocate credit that can be mentioned include the Federal Reserve's down payment and maturity requirements for consumer cash loans that have been imposed at various times, margin requirements on loans secured by securities, and moral suasion (or threats) by the Federal Reserve Board designed to get banks to forbear from lending for what the authorities consider to be socially undeserving projects.[36]

The Present Situation. Whether housing should be subsidized, while a valid question, need not be addressed here since the laws and regulations designed to support this industry have not achieved this goal. Indeed there is reason to believe that these constraints have had the opposite effect. These conclusions are based on considerations of the availability and cost of funds for house purchases.

Availability has two dimensions. One is the effect that the number and type of sources have on the quantity (or level) of funds that flow into mortgages. The second is the effect of the variation of the fund flows on house purchases. With respect to the quantity of funds, there is no reason to believe that the required specialization in mortgage lending by a particular set of institutions is either necessary or desirable for funds to flow freely into mortgages. Money is the most fungible of all assets. Mortgage lending requires skills, but there are no barriers or great costs that prevent people from acquiring them or lenders from hiring people who have these skills. As long as there are no constraints on the yields that can be earned by lenders, demands for mortgages will be met by a large number of sources. Even now, people obtain mortgages from mortgage companies and private parties as well as from chartered financial institutions.[37] In addition, people can use their own funds and obtain purchase money mortgages and land sales contracts from the seller (which often are not recorded as mortgages). Furthermore, all of these sources for mortgage funds are available to home buyers in most markets.

Not only are mortgage funds available from many sources, but the evidence does not support the essential assumption that there is a direct and necessary linkage between mortgages and home buying. Mortgages are but one of many means of borrowing money. A house can serve as collateral for funds that are used to purchase other assets. Thus, Dwight Jaffee, who reviewed the relationship between mortgage finance and housing, concludes: "The main effect of developed policies [subsidies and interventions in the mortgage market] has been to extend greatly the use of mortgage debt in the U.S., but without any appreciable payoff in terms of housing investment."[38] From his review of several studies, Allan Meltzer similarly finds "no evidence that the availability of the particular type of credit has any important or lasting effect on the type of assets individuals

[36] Subsidies to borrowers are a much more important means of allocating credit. These extensive (and expensive) programs include the FHA 221 (d)(2) and 235 programs that provide low interest rate, low down payment loans to lower income persons and other house buyers in declining urban areas, education loans, farm loans and small business loans. The cost of these programs in terms of the difference between market rates of interest and the rates charged to the borrowers has been very great and no doubt has resulted in the shifting of resources to those assets and activities that would qualify for the subsidies. An additional cost is the non-repayment of the loans. Since these allocations of credit and their associated costs are not an aspect of banking regulation, as such, they are not considered further here.

[37] As an indication of this fact, note that the $1,503 billion of total mortgages and $992 billion of one to four family mortgages outstanding as of June 30, 1981 were held by the following:

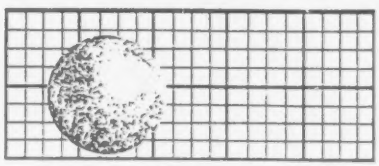
	All	1 to 4 Family
Commercial banks	18.3%	16.8%
Mutual savings banks	6.6	6.6
Savings and loan associations	34.2	43.3
Life insurance companies	9.0	1.8
Federal and related agencies	7.9	6.3
Mortgage pools or trusts	10.1	13.0
Individuals and others	13.8	12.2
Total	99.9%	100.0%

[38] Dwight M. Jaffee, "Housing Finance and Mortgage Market Policy," in *Government Credit Allocation*, Institute for Contemporary Studies: San Francisco, CA., 1975, p. 119.

acquire. If the housing market is the market in which 'availability matters' or matters most, there appears to be very little if any empirical basis for the conjecture on the public policies based on it."[39]

Variation in the amount of funds available for mortgages, though, is likely to be an important short-run deterrent to house purchases. If a mortgage cannot be obtained, at virtually any price, houses can be purchased by very few people. This situation can occur when thrift institutions dominate mortgage lending in an area because laws and regulations give them a comparative advantage over other lenders. (These advantages may be positive, in the form of tax breaks and other subsidies, or negative, in the form of penalties that other lenders can avoid.) Then, when an event such as an unexpected increase in interest rates results in a reduced flow of funds to the thrift institutions because they are unable to offer the market rate for deposits, a major source of mortgages is cut off. Unexpected increases in interest rates also can result in the failure of the specialized thrift institutions, since they are unable to match the maturity (or duration) of their assets and liabilities. Consequently, they are subjected to capital losses when the value of their assets (mortgages) decreases, but they must pay the market rate on their liabilities (time deposits) or face disintermediation. Such failures obviously reduce the flow of funds to mortgages, at least until other lenders obtain the required skills to meet the demand.

Expected variations in fund flows also tend to reduce the flow of funds to mortgages. In this situation, lenders usually find it desirable to maintain assets that can be sold and purchased at relatively low transaction costs. Nonspecialized lenders can hold a mix of assets and liabilities where the expected fund flows tend to offset each other. Since, until recently, thrift institutions generally were not permitted to invest in consumer and business loans and obtain checking account deposits, they tended to hold bonds as a buffer stock (secondary reserve). In those states (such as Connecticut) where the mutual savings banks could hold consumer loans, the institutions tended to hold relatively fewer bonds and more mortgages.[40] Hence, enforced specialization tended to reduce the flow of funds to mortgages.



Turning now to the cost of mortgage funds, it is obvious that the greater the number of lenders vying to make mortgages, the lower the cost to mortgagors. And, the greater the variation of funds to lenders and borrowers, the greater the costs to both. Therefore laws and regulations that restrict entry into the mortgage market and that require financial institutions to specialize in mortgages tend to increase the cost of mortgages.

A final question that should be considered is whether subsidies to thrift institutions in return for their specializing in mortgage lending are likely to be supportive of housing (whether these subsidies are otherwise justified). The subsidies take the form of lower taxes and legally imposed limits on the amounts that can be offered to depositors (Regulation Q). As is discussed above, the first form of subsidy is likely to increase the variation and reduce the flow of funds available for mortgages because of the enforced specialization of the institutions in mortgages and the reduced incentives of other lenders to make this type of loan (witness the virtual withdrawal of life insurance companies from 1 to 4 family unit mortgages). The second is only temporarily useful, even if one assumes that the lower interest rates paid to depositors are passed on to home buyers. As we have seen in the past and are witnessing today, when market interest rates are above the Regulation Q ceilings, disintermediation occurs. The enormous growth of money market mutual funds are due entirely to the desire and ability of savers and enterpreneurs to get and offer the best return on funds. But, unfortunately for those who want to obtain mortgages, the savers who take their money out of the thrift institutions that

[39] Allan H. Meltzer, "Credit Availability and Economic Decisions: Some Evidence from the Mortgage and Housing Markets," in *Ibid.*, p. 149.

[40] See George J. Benston, "Savings Banks and Public Interest," *op. cit.*, pp. 176-176.

JBR

FEDERAL REGULATION

specialize in the mortgages and purchase money market mutual funds shares are actually redepositing their funds principally in commercial banks and are financing corporate and government borrowing. The money market mutual funds tend to hold commercial paper, U.S. treasury issues and the certificates of deposit (CDs) of large commercial banks. They hold these CDs because only CDs over $100,000 can bear market rates of interest and CDs of these amounts are not guaranteed by the FDIC. Hence, the funds would be foolish to risk investment in the CDs of thrift institutions, many of which are in danger of bankruptcy, or of smaller commercial banks, about which information is more expensive to obtain and which are more likely to be permitted by the FDIC to fail than are the very large banks.

The effectiveness of directing credit by regulation toward other specified assets and borrowers has also been found to be slight and often dysfunctional. A number of these studies are surveyed by Thomas Mayer, who concludes: "As the above has shown, credit allocation is not an efficient system. The shifts in the distribution of credit which it tries to bring about are of doubtful value, and, in any case, credit allocation would be ineffective in the long run."[41] When the controls are effective (in the short run), they cause borrowers and lenders to incur the costs of complying with and attempting to avoid the controls. While some borrowers are advantaged and some set of social goals advanced, the effect, at best, is temporary. At worst, the benefits do not flow to those who are presumed to be aided, but to others who are more adept at using regulations to their advantage.

With such credit allocation laws as the Community Reinvestment Act of 1977, harm rather than good is likely to be done to those for whom the law presumably is directed. The law requires chartered financial institutions to direct loans to mortgages on local houses and businesses, particularly if these are in older, blighted areas. If lenders would make these loans without the law, compliance costs are needlessly imposed. If these loans would not be made because the risks exceed the interest rates that can be charged (given institutional or legal constraints), the law encourages institutions to leave the area and discourages others who are similarly regulated from opening branches in the area. In either event, while the volume of loans flowing into the area may be increased initially, the funds will tend to be directed toward the least risky borrowers. As lenders can adjust to the situation, consumers in the area will find fewer sources of funds and other banking services.[42] The law will benefit consumers only if bankers had been discriminating against borrowers for noneconomic reasons and, as a consequence of the law, they were led or forced to give up their taste for discrimination. With respect to mortgages particularly, almost all of the empirical studies find no evidence of discrimination against persons or areas (redlining).[43]

Prevention of Invidious Discrimination and Unfair Dealing Against Persons

The Historical Record. Laws that explicitly prohibit invidious discrimination in the provision of banking services (especially loans) were first enacted in 1968.[44] The Fair Housing Act of 1968 prohibited banks and other lenders from denying mortgages or home improvement loans on account of a person's race, color, religion, sex or national origin. The Equal Credit Opportunity Act (Title VII of the Consumer Protection Act—CCPA— of 1968), enacted in 1974 and amended in 1976, added prohibitions against all credit discrimination on the grounds of age, race, religion, national origin, receipt of public welfare benefits and exercise of rights under the CCPA. The Federal Reserve's Regulation B supplements the law. Regulations written under the dictates of the Community Reinvestment Act of 1977 forbid the alleged practice of denying mortgage and home improvement loans on properties solely because they are old or are located in older areas (redlining).

[41] Thomas Mayer, "Credit Allocation: A Critical View," in *Government Credit Allocation*, Institute for Contemporary Studies: San Francisco, CA.: 1975, p. 91.

[42] For a further analysis, see George J. Benston, The *Anti-Redlining Rules: An Analysis of the Federal Home Loan Bank Board's Proposed Nondiscriminatory Requirements*, Law & Economics Center, University of Miami School of Law: Miami, FL., 1978.

[43] See George J. Benston, "Mortgage Redlining Research: A Review and Critical Analysis," in *The Regulation of Financial Institutions*, Conference Series No. 21, October 1979, Federal Reserve Bank of Boston, pp. 144-195, and *Journal of Bank Research*, 12 (Spring 1981), 8-23.

[44] See Ralph J. Rohner, "Problems of Federalism in the Regulation of Consumer Financial Services Offered by Commercial Banks," in *State and Federal Regulation of Commercial Banks*, Leonard Lapidus and others, Federal Deposit Insurance Corporation, 1980, Volume II, pp. 1-168, especially 16-75 for a good description of the federal and state laws and regulations.

Several laws are directed at providing borrowers with complete information and forbidding certain practices in the belief that without these laws borrowers would be victimized. The Truth-in-Lending Act of 1968 (Title I of the CCPA) requires disclosure of credit costs and terms on consumer loans and long-term leases of consumer goods. It also regulates the content of credit advertising, and regulates credit card distribution, terms and liabilities. The provisions of the Act are implemented by the Federal Reserve's detailed and lengthy Regulation Z. The Electronic Fund Transfer Act (Title IX of the CCPA), enacted in 1978, requires disclosure of account terms, documentation of transfers and prompt error resolution, limits the consumer's liability for unauthorized transfers, and imposes liability for unauthorized transfers by financial institutions. The Real Estate Settlement Procedures Act, adopted in 1974 and amended in 1976, requires mortgage lenders to provide borrowers with a statement of actual charges, forbids kickbacks of settlement fees and tie-ins of sales of title insurance, and limits escrows for taxes and insurance. The Right to Financial Privacy Act of 1978 restricts the right of government agencies to gain access to a consumer's banking records.

Finally, some lending and collection practices of creditors are constrained or prohibited by various laws. The Fair Credit Reporting Act (Title VI of the CCPA), passed in 1970, regulates the content, accuracy and disclosure of credit and investigative reports furnished to creditors, employers and insurers in connection with consumer transactions. Title III of the CCPA establishes a minimum level of wages that are exempted from garnishment and prohibits an employer from firing an employee because of a single garnishment. The Fair Debt Collections Act (Title VIII of the CCPA), enacted in 1977, prohibits abusive and coercive collection practices and requires bill collectors to provide debtors with certain information. It applies to banks only in-so-far as they collect the debts of other lenders. In addition, the Federal Trade Commission's holder-in-due-course rule, issued in 1975, effectively abolished this protection for banks which discounted consumers' notes made to retailers.

In addition, the states have enacted laws that similarly regulate credit practices. Some of these parallel the federal Truth-in-Lending and Equal Credit Opportunity Acts. In several states, notably California, the anti-redlining regulations are more severe than the federal regulations. Most states have usury statutes that stipulate the maximum interest rate that can be charged on various types of loans. These laws are quite diverse and complex. The Uniform Consumer Credit Code, promulgated in 1969, has been adopted by only six states, and they changed various provisions. (In contrast, the Uniform Commercial Code has been adopted virtually intact by almost all states.) Finally, the laws of various states restrict creditors' collection remedies more severely than do the federal statutes. These restrictions on contractual provisions include prohibitions against confession of judgment clauses or cognovit notes, restrictions on collateral available as security, restrictions on deficiency judgments following repossession and limitations on cosigner agreements.

The Present Situation. Assuming (as I do as an ethical value) that invidious discrimination against individuals should not be permitted as a matter of social policy, two questions related to the laws and regulations should be considered. First, are these laws effective in eliminating or reducing invidious discrimination at a cost that is not excessive? Second, is the particular way in which these laws are enforced preferable relative to alternatives? While answers to these questions appear to require value-based assumptions about the meaning of the words "excessive" and "preferable," important aspects of the answers need not await agreement about their operational meaning.

A preliminary question, though, is whether invidious discrimination by financial institutions was a serious problem before the laws were enacted. If such were not the case, the laws simply impose costs on the institutions and their customers without yielding benefits to those whom the laws purport to help. Passage of The Equal Credit Opportunity Act was supported by testimony before the National Commission on Consumer Finance and before Congressional committees that described incidents of invidious discrimination in lending to women.[45] However,

[45] National Commission on Consumer Finance, *Consumer Credit in the United States: Report of the National Commission on Consumer Finance*, Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 1972, pp. 153-156.

any activity, including credit granting, is conducted with some error and insensitivity. When these occur to women, blacks or other persons who have experienced invidious discrimination in other situations the refusal of credit is likely to appear to have been deliberate and unfair. Since testimony by men and whites who were turned down for loans was not heard, it is not possible to know whether the lenders systematically practiced discrimination.

Several studies have been conducted since the hearings that find no evidence of invidious discrimination against women. Chandler and Ewert examined the records of slightly over 2000 credit card applicants at a large metropolitan bank, drawn from applications made between 1971 through early 1974, prior to the passage of the Equal Credit Opportunity Act (ECOA).[46] They constructed credit scoring models to determine the effect of using or not using an applicant's gender as a variable in rejecting or accepting applicants and, if the applicant was accepted, whether the person would be predicted to be a good or bad (loss) payer. They found that when the applicant's gender was included as a variable 22% more females would be accepted compared to excluding gender as is required by the ECOA. Among those accepted, use of gender would have identified 19% more good payers and the same number of bad payers.[47] Thus, if these data are typical, the ECOA regulations tended to make credit cards more difficult to obtain for females and to have imposed greater losses on lenders.

The question of whether commercial banks discriminated against female small loan borrowers before enactment of the ECOA was studied with data obtained by the Federal Reserve from 30 banks in five regions, each consisting of a major metropolitan area plus surrounding environs.[48] Randomly selected data from the pre-ECOA period of 1966-71 included 3,000 charged-off, 12,000 good paid-off and 13,500 new direct consumer loans. These were analyzed with a well-specified model to see if commercial banks systematically discriminated against one sex or another in granting consumer credit by over-securing loans, thereby reducing loss ratios and probabilities, credit-rationing to reduce loss probabilities or charging higher rates to certain borrowers based on sex. The study found: "Overall, the tests provided extensive evidence that commercial banks did not discriminate against potential borrowers based on their sex before ECOA (Equal Credit Opportunities Act) was passed."[49] The only other studies of which I am aware consider possible invidious discrimination in mortgage lending related to the area in which the home is located (redlining) or the race or other personal characteristics of the actual or potential mortgagor. With one exception, all of these find no evidence of invidious discrimination in the denials of loan applications, the types of loans made or the terms charged.[50]

Thus the empirical analyses do not find evidence of discrimination in lending by financial institutions in the years before or after the laws prohibiting such discrimination were enacted. This result is not surprising if one views lenders as people who prefer to maximize their wealth. If they are bigots and if they and their shareholders are willing to accept lower rewards (and it is likely that some are, considering that more than a few people speak and act in this way), it seems unlikely that they would indulge this taste on people with whom their principal contact is a loan agreement and the receipt of repayments (usually by mail).

While the benefits to those who are supposed to be protected by the anti-discrimination acts at best appear to be negligible (and possibly are negative), the costs to financial institutions (and therefore, to their customers) are substantial. James Smith estimated these for compliance with the Federal Reserve's Regulation B that implemented the anti-discrimination provisions of the ECOA.[51] He included the non-recurring costs of legal fees, training and obsolete form removal and the additional costs of printing and

[46] Gary G. Chandler and David C. Ewert, "Discrimination on the Basis of Sex Under the Equal Credit Opportunity Act," Working Paper No. 8, Credit Research Center, Krannert Graduate School of Management, Purdue University, 1976.

[47] Ibid., Table 6, p. 16. The figures are for a .75 cutoff score (a number that determines how stringently credit is granted). At higher cutoff scores (to .80), relatively more applicants are accepted (including bads that should have been rejected). At lower cutoff scores (to .55) the relative differences decline, but even then more rejected female applicants would be accepted, and more good and bad applicants identified.

[48] Richard L. Peterson, "An Investigation of Sex Discrimination in Commercial Banks' Direct Consumer Lending," *The Bell Journal of Economics*, 12, Autumn 1981, 547-561.

[49] Ibid., p. 560.

[50] George J. Benston, "Mortgage Redlining Research: A Review and Critical Analysis," op. cit.

[51] James E. Smith, "The Equal Credit Opportunity Act of 1974: A Cost-Benefit Analysis," *Journal of Economics*, XXXII (May 1975), pp. 609-622.

mailing notices, changing systems, and handling responses due to the requirement that women be informed that they can establish separate credit records. These costs are estimated to be $88.6 million for financial institutions (commercial banks, thrift associations, credit unions and finance companies) and $78.8 million for merchants (retailers, oil companies and other credit card issuers). Recurring costs include increased losses, collection expense and record retention costs. These annual costs are estimated to be $68.8 million for financial institutions and $58.7 million for merchants.

Chartered depository institutions are subjected to additional costs in the form of compliance examinations. Rohner reports that in the fiscal year ended June 1978, 9117 compliance examinations were conducted and $7.1 million was spent by the federal banking agencies (FDIC, Federal Reserve and Comptroller of the Currency).[52] Additional examinations and expenditures were made by state agencies. In addition, the banks incurred additional costs related to the examinations, including the cost of special computer runs, time spent with examiners, and the opportunity cost of constraints on banking operations that examiners might question. Indeed, bankers are reported to find these examinations particularly costly and of very limited benfit to consumers. In a study of the opinions of banks, regulators and consumer specialists toward federal and state regulation, Gloria Elhat elicited opinions on the following aspects of consumer protection: Credit discrimination, disclosure, community reinvestment, creditor practices and remedies, and regulation of loan terms (interest rates, maturities and amounts).[53] She reports most (from 70% to 90%) of the bankers saying that compliance with the consumer protection laws are "very or quite" costly and were not important in protecting consumers.[54] The regulators and examiners interviewed tended to agree with the bankers (though they were not as strongly negative, particularly with respect to the importance of the limitations on creditor practices). Not surprisingly, the professional consumer advocates were of the opposite opinion. Thus all except the consumer advocates believe that the consumer protection laws as administered are considerably more costly than beneficial. Assuming, though, that these laws are not repealed, it seems clear that they can be administered in a more efficient and more equitable manner than by compliance examinations. This issue is considered further below.

[52] Ralph J. Rohner, *op. cit.*, p. 107.

[53] Gloria A. Elhat, "The State and Federal Regulation of Banks: Interpretive Analysis and Principal Findings of a Survey of Bankers, Regulators and Consumer Specialists," in *State and Federal Regulation of Commercial Banks*, Leonard Lapidus and Others, Federal Deposit Insurance Corporation, Washington, D.C., 1980, pp. 406-424, 492-502, 542-557.

[54] Similar findings are provided by a "representative nationwide sample of 1583 chief executive officers of national, state member and state nonmember banks" conducted in 1976 by the FDIC. An average of 91 percent said these examinations were "very or quite costly." Randall J. Miller, "On the Cost of Double Supervision for Insured State Chartered Banks," in Leonard Lapidus and Others, *Ibid.*, pp. 376-380.

CONTEMPORARY REASONS FOR AND METHODS OF REGULATING BANKING — A RECAPITULATION

No Longer Relevant Reasons

Taxation. Restriction of entry as a means of enhancing taxes, the initial reason for bank regulation, is no longer relevant. (The effect of differential taxation of depository institutions compared to other suppliers of banking services is discussed below.)

Prevention of Centralized Power. Restriction of entry for this purpose also is no longer relevant, if it ever was. In particular, there is no reason to believe that the removal of all restrictions on branching or holding companies would result in the demise of small, locally-owned banks. Indeed, if further decentralization of banking services is desired, all legal restrictions on entry and the provision of services, by banks as well as other enterprises, should be removed.

Bank Solvency and the Effects of Failures on the Economy. The requirement of deposit insurance has eliminated concerns about bank runs and the consequent effects on the economy. While bank failures, as such, are not desirable, they now are likely to be somewhat less disruptive on employees, customers and local economies than are the failures of most other types of enterprises. Therefore, special government supervision of financial institutions (with the possible exception of mutuals) is no longer justified for this reason.

The Social Goal of Available Banking Services. Regulations that prevent or impede organizations from providing services to the public

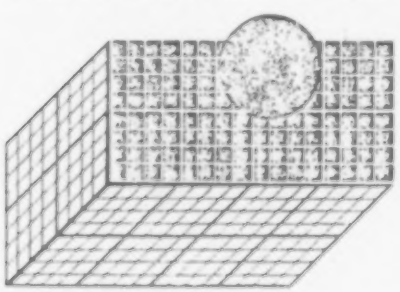
240
JBR

violate this social goal. Consequently, such constraints as limitations on the banking services that thrift institutions can provide, securities services that commercial banks can offer and interest that can be offered to depositors, are undesirable. There also no longer is any reason to subsidize the payments mechanism by maintaining it as a Federal Reserve operation.

Support of Housing and Other Attempts to Allocate Credit. It is unlikely that enforced specialization of thrift institutions as providers of mortgages benefits the production and sale of houses. To the contrary, such specialization tends to increase the variance of fund flows into mortgages, which works a temporary hardship to those who want to buy and sell houses. Interest rate ceilings on deposits and mortgages also restrict the flow of funds to mortgages. Credit directing legislation, particularly the Community Reinvestment Act, raises the cost of lending and is unlikely actually to direct a greater flow of funds to the presumably favored borrowers, except perhaps in the very short run. Such legislation, though, tends to raise costs to bank customers and allocate resources inefficiently. Consequently, if support of the housing market is a social goal, the existing regulations on lenders and prices should be removed.

Possibly Relevant Reasons

Taxation. If the government wants to levy a tax on bank-supplied money, it can do so efficiently by requiring all enterprises that supply this product to maintain a given percentage of the relevant deposits as non-interest bearing reserves with the Federal Reserve. With the exception of equality of reserve ratios among enterprises (larger banks are required to hold higher percentages than smaller banks), this procedure is presently being followed. Any regulation on entry, products supplied, interest paid or charged, etc. would either be unnecessary or counter-productive, since anything that impeded or made more costly the supply of bank-money would favor non-taxed substitutes, such as credit cards.



Money Supply Control. The Federal Reserve can exercise control over the money supply by requiring all suppliers of third-party transfers (demand deposits and close substitutes) to maintain reserves and, possibly, to report statistics. Alternatively, the Federal Reserve could control the money supply simply by predicting the effect of open market operations, on the assumption that the relationship between voluntarily held reserves and money is predictable. In either event, unexpected changes in the money supply and velocity can be reduced by making substitutes for specified third-party transfers less desirable. This can be accomplished by removing the tax on required reserves represented by the opportunity loss on these presently non-interest bearing funds. At the same time, tax subsidies to banks should be removed.

Avoidance of Competition. Regulations that restrict entry are particularly beneficial to those providing a product or service. Thus the present requirement that those who would open banks must obtain a charter, the granting of which is not automatic even if some basic qualifications are fulfilled (such as the obtaining of deposit insurance), provides an opportunity for existing bankers or other competitors to raise objections. Restrictions on inter-state and intra-state branching also serve to reduce competition. Competition is reduced further by laws and regulations that restrict thrift associations from providing a wide range of banking services (most of which have now been removed or reduced), prevent commercial banks from providing securities services, impose interest rate ceilings on deposit accounts, and restrain non-chartered enterprises from providing depository banking services. Indeed, restraining competition is a very relevant past and contemporary reason for regulation. However, as the advantages from avoiding restrictions grow and as technological change and innovations reduce the

cost of avoiding the laws and regulations, the contraints serve predominantly to raise costs to consumers with fewer and fewer benefits to the increasingly less protected producers.

The Protection of Depositors and Bank Solvency. Since the creation of the FDIC and the other federal deposit insurance agencies, this concern is relevant only in-so-far as the requirement of deposit insurance tends to restrict competition and innovation and increase the cost to consumers of credit and other banking services. Solvency, as such, is a currently relevant regulatory problem only for mutual associations, and then only because there are no stockholders and securities market to discipline wayward managers.

Prevention of Invidious Discrimination and Unfair Dealing Against Persons. The legislative history indicates that this concern is currently relevant, even though there is no scientifically acceptable evidence that supports the underlying belief that financial institutions invidiously discriminated, at least in recent times. The present procedure of compliance examinations, though, is neither cost-effective or fair. Further discussion and an alternative method are presented below.

RECOMMENDATIONS

Regulatory Agencies

Comptroller of the Currency. Other than as a means of allowing existing suppliers to avoid competition, there is almost no purpose served by requiring those who would provide banking services and banks which would provide other services to obtain regulatory permission. But, since state laws require banks to have charters, and since depository insurance is desirable to protect banks from runs and depositors from losses, the Comptroller of the Currency (and the Federal Home Loan Bank Board) should be directed to provide charters to any corporation that offers demand deposit or similar services to the public as long as it has obtained satisfactory insurance. The Comptroller (or the FHLBB) also would issue permits to foreign banks to have offices in the United States. The only conditions imposed on these banks would be that they have deposit insurance comparable to that required of U.S. banks. The Comptroller also would be responsible for getting foreign countries to accept U.S. banks' offices. The principal function of the Comptroller, then, would be to evaluate and approve a list of insurance companies and be assured that coverage is maintained. Examination and other supervisory functions are the concern only of the insurers.

Federal Home Loan Bank Board. The functions of this agency are similar to those of the Comptroller of the Currency. Its continued existence is justified for two reasons. First, it provides potential and present federally chartered deposit providers with an alternative to the Comptroller of the Currency. The ability of banks to switch to another chartering agency, even if seldom exercised, constrains the agencies somewhat from attempting to expand their control. Second, the FHLBB administrators have experience in dealing with thrifts and with mutual associations. Therefore, until this situation changes, the FHLBB would charter mutual savings and loan associations and mutual savings banks. If these institutions should wish to convert to stockholder status, this agency would be charged with seeing that the public was not cheated. This could be accomplished by supervising the sale of stock by the mutual institutions, the proceeds of which would be returned to the U.S. Treasury (since a large portion of the equity in the associations is due to favorable tax laws and protective regulations).[53] For those institutions that remain mutuals, the FHLBB would provide residual authoritative control, should it be necessary to remove or discipline incompetent or dishonest officers.

Federal Home Loan Banks. These institutions already operate as if they were privately owned banks. They should be considered as such, with ownership transferred entirely to the member associations in the form of marketable stock. At this point, there is no reason for them to be treated differently than other banks, particularly with respect to taxation and Treasury guarantees of their debt obligations.

National Credit Union Administration. Since credit unions are mutuals and often operate as charitable or fraternal organizations, some chartering and residual administration is likely

[53] Some compensation in the form of founders' stock also should be awarded to the officers of the mutuals whose efforts were responsible for a portion of the equity and who would lose a portion of their association "privileges" to stockholders.

242
JBH

to be necessary. These services would be provided much as they are now.

The Federal Reserve Board. The Fed should function solely as a central bank that is concerned only with control of the money supply and the collection of statistics that are considered necessary for this and other governmental tasks. Membership in the Federal Reserve has been an anachronism for some time (roughly not long after the Fed was founded as a government bank rather than as the originally intended bankers' bank). With the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, which required reserves of all depository institutions and allowed them access to the Fed's services, membership now has almost no meaning. Hence, the Fed should forego its examinaton and supervision of state member banks.[56] Since there is no present purpose (other than restrictions on competition) of bank holding company legislation and since there is no reason to treat bank mergers as different than any other type of mergers, these aspects of Federal Reserve bank supervision are not required.[57]

The Federal Reserve's payments system should be set up as a private corporation, with the marketable stock distributed to the member banks in exchange for their stock in the Federal Reserve. The Fed's related buildings, equipment, other assets, liabilities, and personnel should be ceded to this new corporation.

Since it controls base money, the Fed would continue to be the "lender of last resort." Its borrowing facilities would be available to all institutions that maintained reserves with it. Should an institution wish to borrow reserves, it could do so only at a penalty rate. Furthermore, the institution's deposit insurance company would have to be notified and its objections (if any) would have to be considered since the insurer bears the cost of a failure.

The Federal Reserve, then, would only maintain the reserves of providers of third-party transfers, transfer balances upon request by the newly private payments system corporation and banks that have reserves at the Fed, issue currency (at a fee) to banks and others, continue to collect statistics and serve as the lender of last resort. This reduction in responsibility would free it to improve its management of the money supply.

Depositors' Insurance

All institutions that offered funds transferred on demand would be required to have depositors' insurance. The insurance companies would have the responsibility of estimating the risk assumed and setting the insurance fees. By agreement with the institutions in which depositors' accounts are insured, the companies might conduct field examinations and maintain the power to remove officers, issue cease and desist orders, and have the institutions' stockholders increase their investments. The deposit insurers' powers and responsibilities would be similar to those of other insurance companies, with the practices employed tailored to the risks undertaken.

To control the insurers' power and work toward greater monitoring efficiency, depository institutions should be permitted to purchase insurance from any company approved by their chartering agency. These companies would include the FDIC, FSCIC and NCUSIF. They would remain government agencies, at least for the present. But other private companies, including banks, could enter the market. As a consequence of competition, the insurers have an incentive to set the fees charged and conduct examinations in an efficient manner. If they conduct unnecessary or inefficient examinations and fail to adopt cost-effective procedures for assessing risk and keeping the insured institutions from engaging in overly risky and potentially fraudulent behavior, the institutions have an incentive to get insurance from another agency or company. But if the insurers do not institute effective controls, they bear the costs of failures and frauds. Given this incentive, there is no role for the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Home Loan Bank Board or the National Credit Union Administration to play (except as noted above for mutuals).

[56] For an analysis that concludes that bank supervision and examination is unrelated to money supply, interest rate or credit control, see George J. Benston and John Tepper Marlin, "Bank Examiners' Evaluation of Credit: An Analysis of the Usefulness of Substandard Loan Data," *Journal of Money, Credit and Banking*, VI (February 1974), pp. 23-44.

[57] See Merton H. Miller and Richard A. Posner, "An Approach to the Regulation of Bank Holding Companies," *Journal of Business*, Vol. 51 (1978), p. 379-411, for a review of the law and the arguments for and against special regulation.

Bank Holding Company Regulation

Bank holding companies presently are regulated by the Federal Reserve. Since the affiliated banks may be chartered by states and by the Comptroller of the Currency, this regulatory structure is subject to inter-agency conflicts and inadequate supervision.[58] In addition, the Federal Reserve has the responsibility of approving multi-bank holding company acquisitions but not the authority to grant charters or approve branches, both of which could offset the possible anticompetitive effects of a reduced number of independent banking firms.

If the recommendations set forth here are adopted, these problems will disappear. Entry will be essentially unrestricted and banks will no longer be supervised, except by their insurance agency or company and by the same authorities that are concerned with other enterprises (e.g., the SEC and the Justice Department). The deposit insurer, which is concerned that the insured bank does not waste its assets, may look to the bank's arrangements with its parent (if it is a subsidiary corporation) and with related corporations. (Similarly, the insurer would be concerned about any arrangements that are likely to be conducted at less than arm's length.) Furthermore, the insurer probably would want the distinction between the insured bank and non-insured related companies to be clear to the public, perhaps by insisting on quite different names. In any event, neither the Federal Reserve nor any other banking agency would have a role to play.

Anti-Discrimination and Other Consumer Protection Laws

Economic reasoning and evidence supports the conclusion that consumers are protected best by competition among suppliers for the consumers' trade. Therefore, the social objective of benefiting consumers will be served by removing legal barriers to entry and inefficiencies that raise costs to consumers, as is recommended above. Laws that make invidious discrimination against consumers illegal and that specify how credit terms are to be stated and which specified collection practices may not be required additionally.

But the anti-discrimination laws serve a symbolic function as well as provide a basis for the legal authorities to investigate and act on consumer complaints. And the credit practice laws may be justified as protecting ignorant and powerless consumers from a relatively few unscrupulous suppliers (though such scoundrels usually are quite willing to break the law). However, if the laws are to be effective and fair, they should apply to all suppliers of credit and other banking services. Financial institutions clearly are not the sole suppliers of these services, and if the recommendations made herein are adopted, they will be even less so. Indeed, more consumer credit is supplied by retail stores, mortgage bankers, consumer finance companies and sales finance companies than by depository institutions.

The present difference in the application of anti-discrimination and credit practices laws among suppliers of credit is that only the depository institutions are subjected to compliance field examinations. Not only is this difference in administration unfairly burdensome to a sub-set of credit suppliers, but there is no reason to believe that the result is beneficial to consumers. The costs of the examinations are considerable, both for the examining agencies and for the institutions examined. Furthermore, because depository institutions tend to serve more highly educated and wealthier individuals than do other suppliers of credit, laws designed toward protecting the ignorant and powerless should not be applied more stringently to them than to other suppliers. On the possible benefits side, studies have found no evidence of discrimination in credit granting by banks before the laws were enacted nor (to my knowledge) have studies been publicly released that show improvements. Furthermore, the use of field examinations to determine whether a law has been violated is contrary to most U.S. legal practice. The only other similar instances of which I am aware are field examinations for violations of health laws. These are justified as preventing damage to consumers for which compensating damages would not be adequate. But such is not the case for violations of anti-discrimination laws. There-

[58] These problems and some case studies are reviewed by Bernard Shull, "Federal and State Supervision of Bank Holding Companies," in *State and Federal Regulation of Commercial Banks*, by Leonard Lapidus and others, Federal Deposit Insurance Corporation, Washington, D.C., 1980, Volume II, 271-374.

244

fore, field compliance examinations of depository institutions should no longer be conducted. The authority and responsibility for enforcing the anti-discrimination and other consumer protection laws should be vested in the Justice Department or the Federal Trade Commission.

Taxation

Resources tend to be inefficiently allocated when alternative suppliers of goods are subjected to different degrees of taxation. This is the situation for suppliers of deposit services. Because the reserves required against deposits held by the Federal Reserve banks do not bear interest, the suppliers and thus the users of bank money are subjected to a special tax. This tax could be removed by having the Federal Reserve pay interest on the reserves.[19] However, two other important differences in taxation should be mentioned and considered. One is that hand-to-hand currency does not, and in practice cannot, bear interest. Furthermore, if the government chooses to tax with inflation, there is no reason to give part of this tax to the suppliers of bank money via the multiple expansion of deposits. Therefore, some tax on bank money is equitable and efficient. Second, present tax law permits banks, and only banks, to deduct against taxable income the full cost of funds used to purchase interest tax-free state and municipal bonds. (These costs include the operations costs of processing demand deposits less fees charged plus explicit interest payments and implicit payments in the form of lower loan and other charges to depositors). A careful study of the incidence of these taxes and benefits is beyond the scope of this paper. But if taxes on all suppliers of banking services are to be equalized, such a study is necessary (though given political reality, unlikely to be sufficient).

Repeal of Laws

A number of laws should be repealed or suitably amended to remove federal restrictions from financial institutions, as specified above. These laws include the McFadden-Douglas Act, The Banking Act of 1933 as it pertains to bank regulation, The Bank Holding Company Act and The Community Reinvestment Act. Regulations that set ceilings on interest payments and charges (either on demand or time deposits on loans) and that call for compliance field examinations also should be rescinded.

The effect of the changes suggested above on the dual banking system should be mentioned. The states still will have the power to charter banks. They also might choose to examine and otherwise regulate them, but that would be a waste of resources since there is no public interest in this activity. Rather, the states' principal role will be to assure the residents that if the Comptroller of the Currency ever limits the institutions that would serve the state, there is an alternative source of charters. In addition, the states could impose regulations and taxes on banks much as they do on other companies that do business in their jurisdictions.

Conclusion

The suggested removal of almost all legal restrictions that especially constrain financial institutions is based on the underlying assumption that the purpose of regulation is to benefit consumers rather than producers. The historical analysis presented above shows that most of the reasons for regulating banking are no longer relevant. Furthermore, credit is supplied by a very large number of other enterprises, including retail stores, gas stations, mortgage bankers, security brokers, commercial paper dealers, pension funds and insurance companies. Except for the possibility of runs and the propensity of financial intermediaries to be defrauded, banks are no different from other businesses. Consequently, only the requirement that providers of third-party transfers (checking accounts) have deposit insurance should be imposed. Also, the laws forbidding invidious discrimination against individuals and protection to consumers should be reconsidered and, at the least, applied equally to all credit suppliers, and taxes imposed on all suppliers should be equal. Only those suppliers that benefit from keeping the constraints on competition and regulators whose domains would be reduced should object. □

[19] Alternatively the Fed could allocate its portfolio of interest-bearing Treasury obligations to the reserves, which is equivalent to paying interest on the balances and may be more acceptable politically.

FORUM

DO WE REALLY NEED THE SEC?

by George J. Benston

The Securities Exchange Act of 1934 was one of the earliest and, some believe, most successful laws enacted during the New Deal. Although the financial community generally opposed the 1934 legislation, today most brokers, investors, and government officials find it difficult to conceive of successfully operating stock markets without the 1934 act. Yet the economic and legal rationale for regulating the securities market was never examined carefully before the legislation was passed, nor has it since been scrutinized to any great extent.

Much of the Securities and Exchange Commission's impact derives from its financial-disclosure requirements. The issue is not whether disclosure itself is good or bad, but whether the system of public regulation developed by the SEC is effective. The distinction is important, since it might seem that any argument against disclosure is equivalent to an argument for secrecy. Such is not the case. Prior to the passage of the Securities Exchange Act, corporations could disclose what they wished to their current and potential stockholders and, if they were listed on the New York Stock Exchange, American, or Chicago (Midwest) exchange, they had to make their balance sheets and income statements publicly available.

It might seem that any argument against disclosure is equivalent to an argument for secrecy. Such is not the case.

We now have laws that require most publicly owned corporations to file detailed financial statements with the SEC before they can sell stock to the public or have the stock traded by more than a few people. The companies that report must hire accountants (lots of them), lawyers (very expensive), printers (expensive also, since they must work fast and had better not make a mistake), bookkeepers, and clerks. Executive time (highly paid and often even more valuable) also is consumed with making sure the rules are followed. Standing guard over corporate disclosure is the SEC—with the powers of policeman, prosecutor, and judge; a staff of 2,000; and a budget of $94 million in 1984.

This costly and complex system of corporate disclosure might be worthwhile if it resulted in better financial statements, the publication of data that would save investors from making costly mistakes, and improved allocations of resources as well-managed companies were rewarded and poorly managed firms publicly exposed. But there is no evidence that the financial statements published in accordance with the rules established by the SEC and the Financial Accounting Standards Board (FASB), under the threat of alternative SEC action, are any better for investors than those published before 1934.

Standing guard over corporate disclosure is the SEC—with the powers of policeman, prosecutor, and judge.

This is not to say that the SEC and FASB have not tried. They have struggled valiantly to find the best accounting rules. They have attempted to plug loopholes, reduce alternatives, and provide regulations for all situations. And yet the Holy Grail of true and meaningful accounting numbers continues to escape their grasp for two principal reasons.

First no "true" accounting numbers give the economic position (balance sheet) and changes in wealth (income statement) of an enterprise. These are subjective numbers, since value is in the eye, and the wallet, of the beholder. The accounting numbers generated serve primarily as a control system, to prevent people from cheating stockholders. The numbers are also useful for internal planning by managers who know the context from which they arise and within which they will be used. In addition to giving investors a rough idea of how well a company performed, some of the accounting numbers may help

Page 11 blank

FORUM

predict how well the company will do in the future. But neither the SEC, FASB, most security analysts, nor even university professors know which numbers used in what way are best for this purpose.

The second reason is that a regulatory agency such as the SEC, no matter how well staffed, necessarily must be conservative. As a precaution, it will require more information from corporations than is needed, since some of the data may be of use. After all, the SEC does not pay for these reports, and it risks criticism for not requiring something that turns out to be important. We may go through more periods like the present one, when deregulation is popular and the reduction of burdens is considered a good thing. But as long as the SEC actively pursues its mandate, it is likely to increase, rather than reduce, reporting requirements.

A better way to regulate financial accounting reports is the system that we originally set out to copy—the British system of disclosure and registration. Under the U.K. Companies Acts, corporations must disclose a minimum number of specified items such as sales and payments to directors. Their statements are filed with the Department of Trade, which does nothing unless someone complains—then it undertakes an investigation. Fraud is investigated by a special unit of the police.

As long as the SEC actively pursues its mandate, it is likely to increase, rather than reduce, reporting requirements.

The United States regulates more activities than Britain, and uses more complex disclosure regulations and more formal administrative procedures. SEC regulations require at least 65 items on corporate balance sheets, compared to 39 items in Britain. On the income statement, the U.S. asks for 53 items, compared to 37 in the U.K. Quarterly statements and monthly reports are required in the United States but not in the United Kingdom.

Prospectuses that accompany stock offerings are also more detailed and extensive in the United States, usually running 50 or more pages, compared to 1 or 2 pages in the United Kingdom. In Britain, prospectuses are not needed for any issues that are in all respects similar to securities already listed. Furthermore, many instruments, such as interests in petroleum wells, limited-partnership interests, and investment plans, are considered securities in the U.S but not in the U.K.

To skeptics who consider voluntary disclosure an impractical or infeasible goal, the existing U.K. system of disclosure is worthy of attention. While the United States relies on public regulation of financial disclosure by the SEC, the United Kingdom relies primarily on private regulation by the stock exchange and, to an increasing extent, by the institutes of chartered accountants. The available evidence suggests that the securities market in Britain is just as efficient as the American market, and no more susceptible to fraud.

The available evidence suggests that the securities market in Britain is just as efficient as the American market.

In the early 1930s, President Roosevelt proclaimed that disclosure was the key. As Louis Brandeis put it: "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." Our problem is that instead of simply requiring disclosure, we established the SEC and told its officials: "Prepare and enforce the necessary regulations." They then proceeded to worry about the strength of the disinfectant and the type of electric light. The disclosure principle was lost and the costs imposed on stockholders mounted, yet the stock market does not appear safer for investors. With respect to the regulation of financial accounting reports, the securities acts and the SEC have not done what they were established to do. It is time to consider not just a reform, but a better way: voluntary, unregulated disclosure. ■

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September 21, 1988

Responses by George J. Benston to Questions Submitted by Senator Partick Leahy

1. Q. Do you agree, as a condition to your appointment, to refrain from performing consulting work, research, or other academic projects financed, directly or indirectly, by any bank or financial institution eligible to participate in the Farmer Mac program as a pooler or originator, regardless of the subject matter of the project, during the period of your service on the board?

   A. I agree, as a condition to my appointment, to refrain from any activity that might be construed as a conflict of interest with my duties as a director of Farmer Mac. Before performing consulting work, research, or other academic projects financed, directly or indirectly, by any bank or financial institution eligible to participate in the Farmer Mac program as a pooler or originator, regardless of the subject matter of the project, during the period of my service on the board I will bring the matter to the attention of the board.

   In responding to the question, I note that none of my past research or consulting activities, and no activity that I expect to undertake during the time I will be a director of Farmer Mac, has put me or is likely to put me into a conflict of interest situation. Almost all of this work has been in the nature of basic research or as an expert witness in legal cases.

   For example, I recently appeared as an expert witness in a case in Florida against Prudential-Bache that does not involve an undertaking related to Farmer Mac. My testimony is complete and the case has been decided in a jury trial. I have not as yet received payment for my final accounting, which has already been rendered. It is possible that the attorneys will call on me for further service in this matter. If they do (and I have had no indication at this time that they might), I could not abandon my responsibility to them. Should this occur during my tenure on the Farmer Mac board, I will explain the situation to the board (as the Farmer Mac bylaws require) and follow the board's dictates. Even if the attorneys for Prudential-Bache call on me, the situation may not be relevant, since Prudential-Bache may not be a pooler. Regardless, should I be asked to render further services to Prudential-Bache through its attorneys, I will make this situation known the the board.

   I should point out that I have never obtained and do not ever expect to request a loan that could become part of a Farmer Mac pool from any financial institution, or a loan from any lender that might become a participant in the Farmer Mac program, with the exception of a bridge loan from the Trust Company of Georgia after I purchased my present house in Atlanta, GA and before I sold my home in Rochester, NY. Indeed, I do not see how I can benefit financially, directly or indirectly, from any action that the Farmer Mac board might take; I do expect to benefit, however, from the satisfaction of helping improve the conditions faced by farmers and other rural people and businesses.

2. Q. In your article, "Federal Regulation of Banking: Analysis and Policy Recommendations," Journal of Bank Research, Winter 1983, you argue that almost all government restrictions on market entry for banks should be removed. How should we anticipate that this argument would affect your views towards drafting eligibility standards for poolers of Farmer Mac loans -- regulations which may be viewed as a limitation on market entry?

A. As expressed in this article and in many of my other writings, my research and the research of many other economists leads to the conclusion that consumers benefit when entry of potential suppliers is unrestricted by laws and regulations. However, I (and others) have concluded that the supply of financial services under conditions of a guarantee to users and holders gives rise to a moral hazard problem. When deposits and bonds are guaranteed by the FDIC, FSLIC, or Farmer Mac -- agencies that are backed by the United States Treasury, holders of insured deposits and bonds issued by Farmer Mac poolers tend (and would tend) not to be concerned about the way banks and the poolers operate. The federal deposit insurance agencies and Farmer Mac, therefore, must establish policies and practices that limit the risk that banks and poolers can take. I agree with and applaud the Congress's prescription, as expressed in the legislation establishing Farmer Mac, that the poolers and/or originators should be responsible for at least the first 10% of the losses on each pool of loans. I also believe that poolers (or their designated loan servicers) should establish reserves adequate to meet the liquidity requirements of the bonds that Farmer Mac guarantees. Furthermore, poolers should have sufficient capital to meet operating costs and have demonstrated the technical competence and probity to make the occurrence of operational failure and fraud extremely unlikely. However, Farmer Mac should endeavor to allow all qualified and adequately capitalized poolers to enter the market so that farmers and other borrowers in all parts of the country will be served at the lowest rates that are consistent with the safe and sound operation of FArmer Mac.

September 21, 1988

Responses by George J. Benston to Questions Submitted by Senator Harkin

Questions Asked of All Nominees

1. Q. What role do you envision for the Farmer Mac system in revitalizing the economics of rural areas?

   A. Farmer Mac should reduce the interest payments that farmers and rural families must make on their debt, and increase the amount of funds that are available to them and to other people and businesses in rural areas. Banks that serve rural areas should obtain access to more funds and be better able to balance the duration of their portfolios and reduce their risk exposure, which should subject them to a lower risk of failure and enable them to improve their service to their customers.

2. Q. Do you believe that Farmer Mac should develop specific policies designed to help communities and areas of the country that have special problems of inadequate capital and credit or weak economies?

   A. To the extent that Farmer Mac is successful, people living and serving rural communities and areas should benefit. Farmer Mac should increase the flow of capital to rural areas. This greater flow should be very important where there is inadequate capital because the existing institutions are not able or are unwilling to make longer term loans because they cannot absorb the interest-rate and/or credit risk as a consequence of inadequate diversification or knowledge, or relatively high transactions costs.

3. Q. What should the Farmer Mac board do to address the problems cited in the previous question?

   A. The Farmer Mac board should structure the program to improve the flow and lower the cost of capital to rural areas, particularly to those areas where capital is inadequate.

4. Q. Do you foresee problems of Farmer Mac backed loans going predominantly to an exclusive set of only the best loan prospects?

   A. No. Indeed, it is likely that the best loan prospects are now being adequately served and may not want Farmer Mac's services. Farmer Mac is likely to provide a service that will aid loan prospects who are not "the best." This is not to say that Farmer Mac will accept loans from borrowers who are not likely to repay their debts. By establishing effective underwriting and appraisal standards and standardizing loan and legal forms, Farmer Mac should be able to increase the availability of funds to borrowers without incurring losses that might have to absorbed by taxpayers.

5. Q. What special policies, if any, should the Farmer Mac board implement to ensure that the benefits of the Farmer Mac are made available to the broadest range of borrowers and financial institutions in terms of financial situation and geographic location?

   A. Farmer Mac should (and is) seeking the largest number of originators, located in all states, regions, and communities, as possible. We also should (and are) attempting to interest qualified organizations in all regions of the country into becoming poolers, so that organizations with knowledge and interest in all localities will be included in the Farmer Mac system. The Farmer Mac board should encourage and work with these and with farm and banking organizations to make potential borrowers aware of the benefits that Farmer Mac can offer to them.

6. Q. Do you believe that the Farm Credit Administration has the particular financial expertise necessary adequately to protect the public's interest in its regulation of Farmer Mac?

   A. I am not sufficiently knowledgeable about the FCA's financial expertise to answer this question. However, Congress established this oversight procedure, which would indicate that the FCA does have the required financial expertise. In any event, the Farmer Mac board should establish procedures that would enable any oversight or regulatory body to conclude that the public's interest was protected.

7. Q. Given the federal guarantee backing Farmer Mac, how can the Farmer Mac board help to protect the public interest from unforeseen circumstances, such as another drought? Will Farmer Mac be capable of dealing with a crisis?

   A. Farmer Mac will protect the public interest and serve farmers and other rural borrowers by establishing fair and adequate underwriting and appraisal standards, by following the dictates of the Congress in having poolers put together portfolios that are well diversified in such terms as geography, crop, and borrowers, by monitoring the way portfolios are put together by poolers, and by requiring poolers to hold sufficient capital to establish adequate liquidity reserves so that payments of principal and interest are made to bond holders as promised. If Farmer Mac does its job properly, it should be able to deal with unforeseen circumstances and other crises so as to protect the interests of farm borrowers and the general public.

Additional Questions

8. Q. You have spent a considerable amount of time working on amendments to the Glass-Steagall Act. If you are successful, and banks and insurance companies become able to underwrite securities, what impact will this have on Farmer Mac?

   (A) Would repeal of Glass-Steagall increase or decrease Farmer Mac's share of the agricultural credit market? That is, if money starts flowing out of rural communities and into more lucrative investments, will Farmer Mac be able to fill the void, and what then becomes of borrowers who could not meet Farmer Mac's standards?

A. First, let me correct your understanding of my activities. I have spent no time at all working on amendments to the Glass-Steagall Act. I have spent much time conducting research on the validity of the evidence cited by historians, economists, industry associations, the Supreme Court, government officials, and others about the conditions precedent to the passage of the Act. I also have subjected arguments for and against repeal of the Act to economic analysis. This work has culminated in a book which I am just now completing. I would be pleased to provide you with a copy of the manuscript, and would appreciate receiving any comments you might have about it.

If the Glass-Steagall Act's separation of commercial and investment banking were repealed, I believe the impact on Farmer Mac will be positive. Commercial banks will be permitted to act directly as poolers and distributors of Farmer-Mac-guaranteed bonds, which would increase the availability of funds to farmers and rural homeowners. (Insurance companies are not subject to the Glass-Steagall Act; hence, repeal of the Act would not affect them except that they then would have additional competitors, which would benefit Farmer Mac and farm borrowers.)

Repeal of Glass-Steagall should increase Farmer Mac's share of the agricultural credit market because there would be additional underwriters and distributors of Farmer-Mac-guaranteed bonds. Contrary to the implied assumption of question (A), I do not expect that any more money will flow out of rural communities into more lucrative investments than is now occurring. Money is perhaps the most fungible of all commodities. There is no reason to believe that it is not now going out of and into rural and urban communities in search of the highest returns consistent with the risk that investors are willing to take. However, institutional constraints and transactions costs can limit access to such borrowers as farmers to funds that, in the absence of such constraints and costs, would be made available to them. Farmer Mac can and should help remove these constraints and lower these costs. The repeal of Glass-Steagall should make it easier for Farmer Mac to make more and lower-cost funds available to borrowers in farm communities.

9. Q. (B) What are your views on deregulation of the banking, insurance and financial industries in general?

A. Deregulation of the banking, insurance, and financial industries in general should be beneficial to consumers of financial services, including farmers and other people in rural communities. Deregulation, as I see it, means removing government-imposed constraints that protect them from competition while allowing providers of financial services to offer products and services that consumers demand without constraints on the amounts they can pay for their savings or charge for loans and services other than those imposed by competition in the market place. However, deregulation does not mean that consumers' protection against misdealing, invidious discrimination, and fraud would be removed or the necessity of protecting government-sponsored deposit and loan insurers (such as the FDIC and Farmer Mac) would be neglected. Deregulation, in my opinion, does not mean the removal of supervision, nor does it foreclose the maintenance of reserves adequate for the payment of obligations, and the imposition of audited and enforced standards for adequate capital.

September 21, 1988

Responses by George J. Benston to Questions Submitted by Senator Daschle

1. Q. The underwriting standards set by this board will go a long way towards setting the limits as to who can be served by the secondary market. What is your view as to how tight the standards should be?

   A. The standards should be sufficiently tight to make it extremely unlikely that Farmer Mac will ever have to call upon the $1.5 billion Treasury line of credit made available by the Congress. Given that constraint, the standards should not be so tight as to unduely prevent Farmer Mac from serving rural borrowers. Farmer Mac should not attempt to eliminate all potential losses. That is why poolers and/or originators have been made responsible for at least 10% of the losses incurred by each pool.

2. Q. In your view, what needs to be done before this market is allowed to proceed in order to ensure that it will not unnecessarily expose the Federal Treasury to a loss? In addition, how will you make certain that there is a broad base of participation in the market?

   A. The Farmer Mac board should establish fair and effective underwriting and appraisal standards. Pools of loans should be diversified so that the risk of loss as a result of both possible and unexpected events is less than the amount for which the poolers and/or originators are responsible. Originators in all states, regions, and localities should be encouraged to participate in Farmer Mac. Potential poolers whose headquarters and offices are established in or near rural areas should be encouraged to join the System.

3. Q. In your testimony before the committee, you indicated that you have not received any money for consulting fees from financial institutions, but it appears that your financial disclosure statement indicates that you have received "consulting fees." Were any of these fees from financial institutions?

   A. I used the general term "consulting fees" to cover all types of financial support. The additional detailed confidential statement of direct and indirect sources income that I am providing pursuant to a request by Senator Leahy should provide a specific answer to this question. As this statement shows, the amounts I received from financial institutions were for research projects, educational programs, and expert testimony on contemplated and actual trials.

4. Q. You have been nominated as a "public" member of the board. Do you see the role as a public member as being any different from that of other board members?

   A. My understanding of the role of all members of the board of directors is that they represent the interests of all stockholders. I understand that to be my role as well. I also am mindful of the legislation under which Farmer Mac was established, and of the intent of the Congress that Farmer Mac serve farmers and other rural borrowers as completely and as well as possible, subject to the necessity that Farmer Mac not become bankrupt and have to call on the U.S. Treasury for help, thus imposing costs on the taxpayers.

5. Q. (a) Should the market be extended to cover all agricultural loans, both real estate and non-real estate loans?

(b) Upon writing the underwriting standards, should they reflect the issue of borrowers rights, and how in your view should this be addressed?

(c) Would you advocate a policy of working with borrowers to avoid defaults?

(d) Would you advocate a policy of restructuring loans, if it were the least cost alternative? If not, why not?

A. (a) I believe that Farmer Mac should follow the legislation as established by the Congress. However, the market that Farmer Mac can serve might be extended to all agricultural loans if Farmer Mac has shown the Congress that it can do what it was established to do, and if this extension will enable Farmer Mac to serve the rural borrowers more effectively.

(b) The underwriting standards should reflect borrowers' rights as they are provided for in the statute in sections 8.8 (Standards for Qualified Loans) and 8.9 (Exemption from Restructuring and Borrowers Right Provisions for Pooled Loans). As a member of the Farmer Mac board of directors, I would endeavor to follow any other instructions that the Congress might provide.

(c) I would advocate a policy of working with borrowers to avoid defaults,as is provided for in the statute.

(d) I would advocate a policy of restructuring loans, if it were the least cost alternative.

6. Q. In your writings you mention that entrance barriers to banking should be lifted. How does this finding reflect on your personal philosophy towards government intervention and in particular regulations for the Secondary Market?

A. In general, consumers (including farmers) are best served when there are no restraints on firms and individuals who might want to offer them goods and services, subject to laws and regulations that protect consumers from fraud, misdealing, and invidious discrimination and restrain suppliers from imposing costs on society (externalities). These goals can be furthered by the removal of barriers to the entrance of firms and individuals in the secondary market who might be interested in holding and trading Farmer-Mac-guaranteed bonds. At the present time, I am not aware of any such barriers other than Glass-Steagall Act restraints on commercial banks.

7. Q. What contribution do you feel a Secondary Market can make to rural communities beyond already-existing credit services? Which sector will benefit most from a secondary market?

   A. A secondary market can lower the risk and cost to investors of buying and holding the debt of rural borrowers. Hence, the availability of capital to rural communities should increase and the cost of that capital decrease, thereby benefiting these communities. The secondary market also should enable rural banks to serve their communities better by enabling them to make and service longer-term fixed-rate loans to rural borrowers.

8. Q. Is it Farmer Mac's responsibility to do community outreach?

   A. I believe that Farmer Mac should seek to make potential borrowers in rural communities aware of the benefits from their lenders using Farmer Mac insured pools. This can be accomplished, in part, by encouraging rural lenders to become originators and regional firms to become poolers. Other avenues of outreach should be explored.

BIOGRAPHICAL INFORMATION (PUBLIC)

1. Full name (include any former names used).
   Edward Charles Williamson, Jr.
2. Address: List current place of residence and office address(es). List all office and home telephone numbers where you may be reached. Route 3, Box 98 Camilla, Georgia 31730
   (912)336-0713
3. Date and place of birth.
   June 21, 1944 - Orlando, Florida
4. Marital Status (include maiden name of wife or husband's name). List spouse's occupation, employer's name and business address(es). See Attached
5. Education: List each college and graduate or professional school you have attended, including dates of attendance, degrees received, and dates degrees were granted.
   See Attached
6. Employment Record: List (by year) all business or professional corporations, companies, firms, or other enterprises, partnerships, institutions and organizations, nonprofit or otherwise, including farms, with which you were connected as an officer, director, partner, proprietor, or employee since graduation from college; include a title and brief job description. Are you now or have you ever been an officer or director of any financial institution or entity?
   See Attached
7. Military Service: Have you had any military service? If so, give particulars, including the dates, branch of service, rank or rate, serial number and type of discharge received.
   See Attached
8. Government Service: State (chronologically) your government service or public offices you have held, including the terms of service grade levels and whether such positions were elected or appointed. 1980 - 1983 served as Director of local FmHA Board
   No other government service
9. Honors and Awards: List any scholarships, fellowships, honorary degrees, and honorary society memberships that you received and believe would be of interest to the Committee.
   None
10. Political Affiliation: The statute creating the Federal Agricultural Mortgage Corporation requires that no more than three public members of the Board be from the same political party. List your current political party registration or affiliation.
    I am a Democrat
11. Other Memberships: List all organizations to which you belong, excluding religious organizations.
    Camilla Chamber of Commerce
    Camilla Rotary Club
    Mitchell County Racquet Club
    Mitchell Baker Association for Retarded Citizens

12. Published Writings: List the titles, publishers, and dates of books, articles, reports, or other published materials (including published speeches) you have written. Please include on this list published materials on which you are listed as the principal editor. It would be helpful to the Committee if you could provide one copy of all published material that may not be readily available. Also, to the maximum extent practicable, please supply a copy of all unpublished speeches you made during the past five years on issues involving agriculture, nutrition, forestry or commodity futures policy or related matters.

None

13. Health: What is the present state of your health?

Excellent

EDWARD C. WILLIAMSON, JR.

Answers to Biographical Information

Question Number	
4.	Nan Adams Williamson Self-employed - Nan Williamson Advertising Agency Route 3, Box 98 Camilla, Georgia 31730
5.	Auburn University Auburn, Alabama Bachelor of Arts, History (1968) 1963 - 1968
6.	1968 - 1969 assistant buyer for Rich's, Inc. Department store in Atlanta, Georgia 1969 - 1979 owner and operator of The County Seat A mens and ladies retail clothing store in Camilla, Georgia 1979 - 1988 presently am partner in E & J Farm Management which manages J. L. Adams Farms, Inc. in Camilla, Georgia. I manage approximately 800 acres of pecan trees and assist in the management of peanut and soybean crops.
7.	Joined U. S. Army Reserve in 1962 and served six months active duty. Received honorable discharge in 1971 with rank of E-3, serial number 14770940.

FINANCIAL DATA AND CONFLICT OF INTEREST (PUBLIC)

1. If confirmed, do you have any plans, commitments, or agreements to pursue or continue outside employment or engage in any business or vocation, with or without compensation, during your service with the government? (If so, explain.)
Will continue current job with E & J Farm Management

2. List sources, amounts and dates of all anticipated receipts from deferred income arrangements, stock options, incompleted contracts and other future benefits which you expect to derive from previous business relationships, professional services, firm memberships, former employers, clients, or customers.
None

3. Do you, or does any partnership or closely held corporation in which you have an interest, own or operate a farm or ranch? (If yes, please give a brief description including location, size and type of operation.)
See attached

4. Have you, or any partnership or closely held corporation in which you have an interest, ever received a direct or guaranteed loan from or cosigned a note to the Farmers Home Administration or Farm Credit System? (If yes, give details of any such loan activity during the past five years.)
Annual operating loans from Planters & Citizens Bank are guaranteed by FmHA

5. Do you have any plans to resume employment, affiliation, or practice with your previous employers, business firms, associations, or organizations after completing government service? (If yes, give details.)
I will continue current job during government service - see 1 above

6. Has anyone made a commitment to employ you or retain your services in any capacity after you leave government service? (If yes, please specify.)
Will retain current employment

7. Identify all investments, obligations, liabilities, or other relationships which involve potential conflicts of interest in the position to which you have been nominated.
None

8. If confirmed, explain how you will resolve any potential conflict of interest, including any that may be disclosed by your responses to the above items.
None

EDWARD C. WILLIAMSON, JR.

Answers to Financial Data and Conflicts of Interest Questions

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Question Number	
3.	I am a partner and employee of E & J Farm Management. E & J operates J. L. Adams Farms, Inc. in Camilla, (Mitchell County) Georgia. J. L. Adams Farms consists of approximately 2000 acres of both owned and rented land. The company grows primarily peanuts, pecans, and soybeans. My job is the management of approximately 800 acres of pecan trees with my brother-in-law partner managing the row crop land.

EDWARD C. WILLIAMSON, JR.

Additional Information

Question Number

Biographical Information

6. Are you now or have you ever been an officer or director of any financial institution or entity?

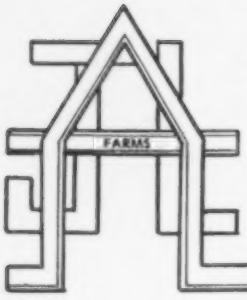
NO

Financial Data and Conflict of Interest

4. Have you, or any partnership or closely held corporation in which you have an interest, ever received a direct or guaranteed loan from or co-signed a note to the Farmers Home Administration or Farm Credit System? (If yes, give details of any such loan activity during the past five years)

YES, in 1988 J. L. Adams Farms, Inc. has a FmHA guaranteed farm operation loan from the Planters and Citizens Bank in Camilla, Georgia for $350,000. Mr. Williamson's partnership, E & J Farm Management, manages J. L. Adams Farms, Inc.

No direct or guaranteed loans were made through FmHA or Farm Credit System prior to 1988.



James Lee Adams, Sr.
James Lee Adams, Jr. (912) 336-8298
Eddie Williamson (912) 336-0713
JL ADAMS FARMS INC.
Rt. 3 - Box 113A
Camilla, Georgia 31730

CERTIFIED SEEDS*

CORN, PEANUTS*, PECANS, SOYBEANS*, SUNFLOWERS, WHEAT*, PINE TREES

QUESTIONS FROM SENATOR DASCHLE
FOR EDWARD CHARLES WILLIAMSON

1. How as a member of the board will you make certain that smaller banks are active participants in the Secondary Market? Do you feel it is the role of Farmer Mac to provide community outreach?

Answer: Senator, Daschel, from the outset the Farmer Mac board has made this issue our number one priority. Both members of the interim board who represent the A.B.A. and I.B.A.A. are presidents of small rural banks. I live in a rural agricultural community of 5,000 and as I stated at the hearing, I am very much interested in small banks surviving and participating in Farmer Mac.

Farmer Mac can provide community outreach by publishing literature to educate not only the rural agricultural banks both also the farmers who so badly need these long term low interest secondary loans.

2. You have been nominated as a "public" member of the board. Do you see the role as a public member as being any different from that of other board members?

Answer: From the very first meeting of Farmer Mac, the board has had no special interest member. The "public" members should be there for one reason and that is to carry out the policy of Farmer Mac that Congress created.

3. Should underwiting standards reflect the issue of borrowers rights? In your view, how should this be addressed?

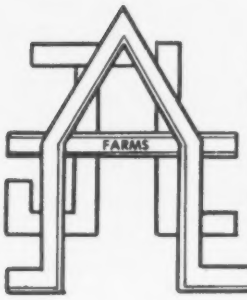
Answer: The underwriting standards concerning the borrowers are defined in Public Law 100-233, on Section 8.6, D-7 and Section 8.9, B. This law was created by Congress with the best expertise in the country. It is my responsibility as a member of the Farmer Mac board to enforce the written law.

4. In your view what benefits will the Secondary Market provide to farmers and ranchers?

Answer: Senator, being a farmer in a small community in South Georgia, I feel this law should be the positive change that agriculture has been so sorely needing these past ten years. Most of my friends who went bankrupt in the 1970-80's did so because of the short term high interest rates. We realize we will always have the short term operating capital loans; however, the Farmer Mac low interest long term loans will give us an alternative. Also, many of my fellow farmers today are over extended with short term, high interest loans. Again, the Farmer will have the opportunity to get a little relief by getting not only a lower interest loan but very possibly a twenty to thirty year long term secondary note.

5. In your view should the Secondary Market benefit all farm real estate borrowers, those who may have difficulty getting credit, or just the most credit worthy borrowers?

Answer: Farmer Mac is designed to help any farmer who qualifies for a Farmer Mac loan. In my view, Farmer Mac should be that for all farmers.



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CERTIFIED SEEDS*

CORN, PEANUTS*, PECANS, SOYBEANS*, SUNFLOWERS, WHEAT*, PINE TREES

QUESTIONS SUBMITTED BY SENATOR HARKIN
FOR EDWARD CHARLES WILLIAMSON

1. What role do you envision for the Farmer Mac System in revitalizing the economics of rural areas?

Answer: The only role Farmer Mac has to play in rural areas is pumping needed money into our farm economy through secondary mortgages. Hopefully, because of Farmer Mac, we farmers will have access to low interest long term notes which are sorely overdue.

2. Do you believe that Farmer Mac should develop specific policies designed to help communities and areas of the country that have special problems of inadequate capital and credit or weak economies?

Answer: You, the Congress, have already mandated the policies for Farmer Mac so we don't necessarily need to set policy. We need to carry out what you have created Farmer Mac for, that is to get financial help to all farmers throughout the United States who can qualify for a secondary loan. As far as areas with special problems, I feel you are talking about depressed farm areas. In South Georgia, where I live, many of my fellow farmers have already gone broke. More important, however, is that there are more farmers who are struggling and low interest secondary mortgages may enable them to survive. Farmer Mac may be one of the answer for small family farms.

3. What should the Farmer Mac board do to address the problems cited in the previous question?

Answer: In my opinion Farmer Mac first has the responsibility to make agricultural secondary mortgages a reality. To do this we need to go out and sell and educate not only the small rural banks and farm credit systems but also to let we farmers know there is some relief for them. Farmer Mac is not a panacea for farmers but lower interest long term notes will certainly give us new hope.

4. Do you foresee problems of Farmer Mac backed loans going predominantly to an exclusive set of only the very best loan prospects?

Answer: It is our duty to see that this fear does not become reality. I do not feel this will be a problem. You see, I am from a town of 5,000 which is totally dependent on agriculture. These banks and farm credit institutions know their customers and unfortunately their farm customers have not been what you call the "best loan prospects." In the past ten years, there have been very few loans made in agriculture which one would call good loans. Times have been tough but the local lenders realize they must take a risk for our farm communities to survive. I feel because of Farmer Mac, banking and farm credit will once again become much more active and the small farmer will be the one who benefits.

5. What special policies, if any, would the Farmer Mac board implement to ensure that the benefits of the Farmer Mac system are made available to the broadest possible range of borrowers and financial institutions in terms of financial situation and geographic location?

Answer: This quite possibly may be the board of Farmer Mac's greatest responsibility. We must have a broad representation of originators throughout the United States. This will happen because of the make up of the Farmer Mac board. The board is composed of leaders in the A.B.A., I.B.A.A., insurance firms and the Farm Credit systems. Every meeting that we have had these members have pushed this policy. Because of the importance the board has put on the policy, our financial consultant, Henry Edelman, and First Boston, our lead underwriter, know that their top priority is for them to have as broad as representation in originators as possible throughout the United States. We will continually remind them of this.

6. Do you believe that the Farm Credit Administration has the particular financial expertise necessary adequately to protect the public's interest in its regulation of Farmer Mac? (FCA approved Farmer Mac Regulations at its 9/6 board meeting.)

Answer: This is way out of my expertise so I feel I cannot answer this question for an obvious reason, lack of knowledge.

7. Given the federal quarantee backing Farmer Mac, how can the Farmer Mac board help to protect the public interest from unforeseen circumstances, such as another drought? Will Farmer Mac be capable of dealing with a crisis?

Answer: Obviously, Farmer Mac is not the sole answer to agriculture and the farmer will always be at the mercy and often misery of the weather. However, the best way for Farmer Mac to protect its interest and the peoples as well is through broad distribution of originators stock. We must sell stock to all agricultural areas throughout the United States. Farmer Mac will be able to deal with a crisis. The logic in this is the same as farmers are doing today and that is diversifying. On our family farm we grow corn, peanuts, soybeans, pecans, wheat, milo and pine trees. Farmer Mac will do the same thing, we will sell stock in all farm sections of the United States.

BIOGRAPHICAL INFORMATION (PUBLIC)

1. Full name (include any former names used) .

Derryl Jay McLaren

2. Address: List current place of residence and office address(es). List all office and home telephone numbers where you may be reached.

I am a farmer/owner and operate as a sole proprietor. My home and business address and telephone are one and the same. Rural Route 1, Box 220
Farragut, Iowa 51639
712-385-8279

3. Date and place of birth.

March 22, 1949
Shenandoah, Iowa (Page County)

4. Marital Status (include maiden name of wife or husband's name). List spouse's occupation, employer's name and business address(es).

Married to Carma Sue Herrig McLaren

Teacher of Talented and Gifted
Sidney Community School
1002 Illinois
Sidney, Iowa 51652

5. Education: List each college and graduate or professional school you have attended, including dates of attendance, degrees received, and dates degrees were granted.

Iowa State University	1971 to 1972	Graduate School (No degree)
Iowa State University	1967 to 1971	B.S.

6. Employment Record: List (by year) all business or professional corporations, companies, firms, or other enterprises, partnerships, institutions and organizations, nonprofit or otherwise, including farms, with which you were connected as an officer, director, partner, proprietor, or employee since graduation from college; include a title and brief job description. Are you now or have you ever been an officer or director of any financial institution or entity?

YEAR	ENTITY	DESCRIPTION

1971-72	Iowa State Univ.	Teaching Assistantship
1972-73	Farragut Elevator	Assistant Manager
1972-88	Self-employed	Farming
1987-88	M.M.& D. Farms	Director & President
1984-88	Friends of Ag.	Executive Committee
1979-88	Iowa Corn Growers	Director Vice-Pres. '83-85
1982-88	Iowa Corn Promotion	Director President '85-87 Vice-Pres. '84-85 Treas. '83-84
1987-88	National Corn Growers	Director
1987-88	U.S. Feed Grains Coun.	Director Committee Chair
1982-86	National Corn Dev. Found.	Director Committee Chairs

I have never been an officer or director of any financial institution or entity.

7. Military Service: Have you had any military service? If so, give particulars, including the dates, branch of service, rank or rate, serial number and type of discharge received.

NO

8. Government Service: State (chronologically) your government service or public offices you have held, including the terms of service grade levels and whether such positions were elected or appointed.

NONE

9. Honors and Awards: List any scholarships, fellowships, honorary degrees, and honorary society memberships that you received and believe would be of interest to the Committee.

Goke Scholarship (communications) - Iowa State

Des Moines Register "Up and Comer" (1986)

Harvard Agri-Business Seminar (1987)

Phi Eta Sigma

Alpha Zeta

Gamma Sigma Delta

Phi Kappa Phi

Graduated "With Distinction" - Iowa State

10. Political Affiliation: The statute creating the Federal Agricultural Mortgage Corporation requires that no more than three public members of the Board be from the same political party. List your current political party registration or affiliation.

Republican

11. Other Memberships: List all organizations to which you belong, excluding religious organizations.

American Farm Bureau

American Soybean Association

12. Published Writings: List the titles, publishers, and dates of books, articles, reports, or other published materials (including published speeches) you have written. Please include on this list published materials on which you are listed as the principal editor. It would be helpful to the Committee if you could provide one copy of all published material that may not be readily available. Also, to the maximum extent practicable, please supply a copy of all unpublished speeches you made during the past five years on issues involving agriculture, nutrition, forestry or commodity futures policy or related matters.

I have submitted oral and written testimony four times to Senate and House committees on the issue of farm credit, twice to Congressman Ed Jones' House Ag. subcommittee as a member of the National Corn Growers Association and twice to Senator Grassley's Judiciary subcommittee as an individual farmer.

13. Health: What is the present state of you health?

Good

Financial Data and Conflict of Interest (Public)

1. If confirmed, do you have any plans, commitments, or agreements to pursue or continue outside employment or engage in any business or vocation, with or without compensation, during your service with the government? (If so, explain.)

NO

2. List sources, amounts and dates of all anticipated receipts from deferred income arrangements, stock options, incompleted contracts and other future benefits which you expect to derive from previous business relationships, professional services, firm memberships, former employers, clients, or customers.

NONE

3. Do you, or does any partnership or closely held corporation in which you have an interest, own or operate a farm or ranch? (If yes, please give a brief description including location, size and type of operation.)

I have a 1/3 interest in 276 acres, more or less, in sections 34 and 35 of Fisher township, Fremont County, Iowa, and a 1/3 interest in 151 acres, more or less, in section 28 of Walnut township, Fremont County, Iowa. M.M. and D. Corporation has an undivided 40% interest in 302 acres, more or less, in Walnut township, Fremont County.

4. Have you, or any partnership or closely held corporation in which you have an interest, ever received a direct or guaranteed loan from or cosigned a note to the Farmers Home Administration or Farm Credit System? (If yes, give details of any such loan activity during the past five years.)

My father, brother, and I purchased 276 acres of land in 1979 in equal shares and secured a loan from the Federal Land Bank. The loan is supported by an additional 240 acres and is fully collateralized.

5. Do you have any plans to resume employment, affiliation, or practice with your previous employers, business firms, associations, or organizations after completing government service? (If yes, give details.)

The only plans I currently have are to continue operation and management of my farming enterprise and maintain ownership of stock in our family corporation, M.M. and D. Farms, Corporation.

6. Has anyone made a commitment to employ you or retain your services in any capacity after you leave government service? (If yes, please specify.)

NO

7. Identify all investments, obligations, liabilities, or other relationships which involve potential conflicts of interest in the position to which you have been nominated.

I am currently a director on the boards of the Iowa Corn Growers Association, Iowa Corn Promotion Board, U.S. Feed Grains Council, and the National Corn Growers Association. My involvement with the Iowa Corn Promotion Board and the U.S. Feed Grains Council will cease effective September 1, 1988. My term on the Iowa Corn Growers Association will expire in February of 1989, and my term on the National Corn Growers will expire in February of 1990.

8. If confirmed, explain how you will resolve any potential conflict of interest, including any that may be disclosed by your responses to the above items.

As an active farmer representing the general public, I am sensitive to the additional scrutiny in relation to possible conflict of interest in the sourcing of business credit. If confirmed, I will maintain that sensitivity and seek appropriate counsel if a potential conflict of interest should arise.

QUESTIONS SUBMITTED BY SENATOR HARKIN FOR ALL NOMINEES

#1 What role do you envision for the Farmer Mac system in revitalizing the economies of rural areas?

The Farmer Mac system will increase competition among financial entities for agriculture mortgages and provide liquidity to new and existing participants. The underlying investment atmosphere of rural areas will benefit to the extent of increased liquidity and competitive interest structure. Any industry needs access to capital; Farmer Mac will provide new capital.

#2 Do you believe that Farmer Mac should develop specific policies designed to help communities and areas of the country that have special problems of inadequate capital and credit or weak economies?

Farmer Mac will guarantee loans presented by originators and then pooled for public sale. The geographical distribution of loan pools should help insure access by all areas of the country. Farmer Mac will not displace existing sources of credit, but rather increase the availability of credit for the sourcing of farm mortgages.

#3 What should the Farmer Mac board do to address the problems cited in the previous question?

To insure that all communities and rural areas have access to the secondary market, Farmer Mac should be aggressive in educating local financial entities, farmers, and the general public in the use of the guaranteed loans. Stock purchase requirements by financial entities should not be restrictive or cost prohibitive for participation.

Any industry needs the availability of equity and credit capital. Farmer Mac should strengthen the farm economy by providing additional capital and allowing local lending institutions to better service their borrowers through a broader range of credit vehicles.

#4 Do you foresee problems of Farmer Mac backed loans going predominantly to an exclusive set of only the very best loan prospects?

I don't foresee the establishment of an exclusive loan portfolio. The interim board is currently preparing loan standards to recommend to the permanent board. I would anticipate those standards to be flexible to service a broad base of eligible borrowers.

#5 What special policies, if any, should the Farmer Mac board implement to ensure that the benefits of the Farmer Mac system are made available to the broadest possible range of borrowers and financial institutions in terms of financial situation and geographic location?

The loan standards enacted by the board should be flexible enough to service a broad base of eligible borrowers. The stock offerring should be designed to appeal to a wide range of financial institutions, and establishment of numerous poolers should encourage participation.

#6 Do you believe that the Farm Credit Administration has the particular financial expertise necessary adequately to protect the public's interest in its regulation of Farmer Mac? (FCA approved Farmer Mac regulation at its 9/6 board meeting.)

I don't feel that I am qualified to answer this question. In relation to Farmer Mac, as a board member, I will strive to work with FCA within the statutory authority given them by the Agriculture Credit Act of 1987.

#7 Given the federal guarantee backing Farmer Mac, how can the Farmer Mac board help to protect the public interest from unforeseen circumstances, such as another drought? Will Farmer Mac be capable of dealing with a crisis?

For the investing public, Farmer Mac should exibit several financial strengths. Besides being a national entity, it will display both commodity and geographic diversity. These characteristics should help Farmer Mac deal with climactic and regional difficulties.

SUBMITTED BY:

Derryl McLaren

Derryl McLaren

QUESTIONS FROM SENATOR DASCHLE FOR DERRYL JAY MCLAREN

#1 How as member of the board will you make certain that smaller banks are active participants in the secondary market? Do you feel it is the role of Farmer Mac to provide community outreach?

Participation by smaller banks will be governed largely by specifications and requirements of originators of loans, common stock structure, and working knowledge of the board's services. As a member of the board, I will strive to accommodate the access of small banks to this secondary market vehicle and provide education of its services to local financial entities.

Since the Federal Agricultural Mortgage Corporation will be providing new lending opportunities for small community banks, education is very important. As a board member, I will encourage cooperation in preparation and distribution of materials to familiarize loan participants with the secondary market.

#2 You have been nominated as a "public" member of the board. Do you see the role as a public member as being any different from that of other board members?

As a public member, I have no personal financial interest to enhance. It is my responsibility to see that the board provides access and service to financial entities and potential borrowers as outlined by the authorizing legislation. As the ultimate purchaser of loan obligations, the general public must be assured of the financial integrity of the loans.

#3 Should underwriting standards reflect the issue of borrowers rights? In your view, how should this be addressed?

The Agriculture Credit Act of 1987, of which the Federal Agricultural Mortgage Corporation is a part, is a comprehensive credit package. As a board member, I will work within the context of the statute and strive to see that all borrowers are treated in a fair and equitable manner.

#4 In your view what benefits will the Secondary Market provide to farmers and ranchers?

The Secondary Market should stimulate competition among financial entities for agriculture mortgages. By opening a new avenue of credit availability and additional servicing

entities, agriculture producers should benefit through the resulting lower interest rates. In addition, the liquidity provided local financial entities by the Secondary Market should increase the availability of credit in local communities. In short, the Secondary Market will provide increased availability of loanable funds at competitive interest rates.

#5 In your view should the Secondary Market benefit all farm real estate borrowers, those who may have difficulty getting credit, or just the most credit worthy borrowers?

All farm real estate borrowers should benefit as a result of increased liquidity of banking and FCS entities and the competitive interest rate structure. The Secondary Market will provide guarantees on agriculture loans. The guarantee will be balanced against the risk associated with the loan requirements of individual borrowers within the pools. It is important to note that the Secondary Market will not displace existing sources of credit available to farmers and ranchers, but rather enhance the choices of agriculture producers in accessing credit.

SUBMITTED BY:

Derryl McLaren

Derryl McLaren

QUESTIONNAIRE FOR FEDERAL AGRICULTURAL MORTGAGE CORPORATION NOMINEES

BIOGRAPHICAL INFORMATION (PUBLIC)

1. Full Name: Gordon Clyde Southern

2. Address: P O Box 116, Steele, MO 63877, Office in home, located 1 1/2 miles West of Steele on Highway 164.
Home: 314 695-3470 Business: 314 695-3075

3. Date and place of birth: August 16, 1926 at Steele, Missouri

4. Marital Status: Married to Betty Dodds Southern, Housewife, former school teacher, address as above.

5. Education: David Lipscomb College, Nashville, TN. 1946 to 1947 One year credit, pre legal curriculum.

SEMO State College, Cape Girardeau, MO. 1947 to 1948 One year credit, pre legal.

U.S. Army Command and General Staff College, Fort Leavenworth, Kansas, Diploma, March 17, 1972.

Industrial College of the Armed Forces, Washington, D.C. Nat Security Management, Diploma, 2-12-75.

Air War College, Maxwell Air Force Base, Alabama, Diploma, July 17, 1978.

University of the State of New York, Regents External Degree, BS, in Liberal Studies at Albany, N.Y. on March 23, 1979, Diploma # 1751.

6. Employment Record:

Retail Credit Co (now known as Equifax), August, 1948 to November, 1950, Blytheville, Arkansas, Duties, Investigated credit and financial background.

U.S. Army, Active Duty, November, 1950 to October, 1953, served in Korea, 45th Inf Division, Commanded Tank Company.

Retail Credit Co, October, 1953 to March, 1958. Duties same as above.

Self-Employed as part-time farmer, 1954 to 1958. Steele, Mo., same as present location.

Self-Employed, farming full-time from March, 1958 to present time. Steele, Missouri, as above. Southern Farm Co., Inc., President, family held corporate structure, at Steele, Missouri, since

February, 1978. Total row crop acreage of 2,850 acres, consisting of corn, wheat, milo, soybeans and cotton.

Pemiscot County Port Authority, Caruthersville, Mo. Non-profit govt, serving as Chairman, since 1974.

Pemiscot County Farm Bureau, Caruthersville, MO., Non-profit, serving as V. President.

Bootheel Resources, Conservation and Development Commission, Dexter, Mo., Non-profit, serving as director from Pemiscot County, since 1975.

Drainage District #1, Pemiscot County, MO., Non-profit, serving as President.

Pemiscot County Industrial Development Authority, Non-profit, serving as director since 1980.

I am not now, and have never been an officer or director of any financial institution or entity.

7. Military Service:

U.S. Army, November, 1950 to November 1951, Private, Fort Leonard Wood, Missouri.

U.S. Army, November, 1951 to March, 1952, Armored OCS Fort Knox, Ky., commissioned 2nd Lieutenant.

U.S. Army,Fort Hood, Tx., and Korea, until October, 1953, released to Ready Reserve status, 1st Lieutenant.

U.S. Army, Active Ready Reserve, from October, 1953 until September, 1981, placed in Retired Status, with rank of Colonel, O-6. Short Tours of Active Duty during the Vietnam War. Army Serial Numbers were: US55059145, 01883219, and 415-44-8572.

8. Government Service:

United States Post Office Department, following College. 1944 to 1946, Clerical duties, CAF-4, resigned to attend College.

9. Honors and Awards:

Military -- Bronze Star and Legion of Merit.

10. Political Affiliation: Republican.

11. Other Memberships:

American Legion, Reserve Officers Association, The Retired Officers Association, Mo Sheriffs Association, American Soybean Association, Farm

Bureau, Missouri Cotton Producers, Agriculture Council of Arkansas.

12. Published Writings: None.
Unpublished Speeches: See Enclosure # 1.

13. Health: Normal, healthy and active.

FINANCIAL DATA AND CONFLICT OF INTEREST (PUBLIC)

1. If confirmed, do you have any plans, commitments, or agreements to pursue or continue outside employment or engage in any business or vocation, with or without compensation, during your service with the government? (If so, explain.)

Answer: Yes, I plan to continue my activity with Southern Farm Co., but making myself available to duties as required on the FAMC.

2. List sources, amounts and dates of all anticipated receipts from deferred income arrangements, stock options, incompleted contracts and other future benefits which you expect to derive from previous business relationships, professional services, firm memberships, former employers, clients, or customers.

Answer: Income will consist of two sources (a) net farm income (b) Army retirement at $11,591.40 per year. No deferred income arrangements, stock options, incompleted contracts or other future benefits from any source.

3. Do you, or does any partnership or closely held corporation in which you have an interest, own or operate a farm or ranch? (If yes, please give a brief description including location, size and type of operation.)

Answer: Southern Farm Co., Inc is a closely held family corporation. I serve as President and own 50% of the stock. A brother, Wayne Southern, owns the other 50%. We farm approximately 2,850 acres of land in Pemiscot and Dunklin counties in the Missouri Bootheel, and crops are soy beans, corn, milo, wheat and cotton. I own 900 acres of land which is farmed by the above corporation.

4. Have you, or any partnership or closely held corporation in which you have an interest, ever received a direct or guaranteed loan from or cosigned a note to the Farmers Home Administration or Farm Credit System? (If yes, give details of any such loan activity during the past five years.)

Answer: Farmers Home Administration - None
Farm Credit System - Yes, See Inclosure # 2.

5. Do you have any plans to resume employment, affiliation, or practice with your previous employers, business firms, associations, or organizations after completing government service? (If yes, give details.)

Answer: Yes. Plan to continue farming operation, and other associations.

6. Has anyone made a commitment to employ you or retain your services in any capacity after you leave government service? (If yes, please specify.)

Answer: No.

7. Identify all investments, obligations, liabilities, or other relationships which involve potential conflicts of interest in the position to which you have been nominated.

Answer: None.

8. If confirmed, explain how you will resolve any potential conflict of interest, including any that may be disclosed by your responses to the above items.

Answer: No conflict of interest now or anticipated.

QUESTIONNAIRE FOR FEDERAL AGRICULTURAL MORTGAGE CORPORATION NOMINEES

Enclosure # 1, Unpublished Writings and Speeches (7)

STATEMENT -- BELLE FOUNTAIN PROJECT
PUBLIC MEETING HELD BY U.S. CORPS OF ENGINEERS ON 31 MARCH, 1981
AT CARUTHERSVILLE, MISSOURI

My name is Clyde Southern, and I am a farmer in Pemiscot and Dunklin Countie of S.E. Missouri. I serve on the board of directors of Drainage District #1

For many years I have observed with great interest and expectation, the emergence of the Belle Fountain Project, which primarily concerns Pemiscot County. Drainage has always been the key, and secret weapon for the successof agriculture and economic development of this area. The area served by this planned project is one of the most fertile and productive in the world, and acre for acre, it will provide as much or more food and fiber than any other part of the state of Missouri. The population of the world doubles about every 30 years, and we are going to be hard-pressed to feed the hungry by the turn of the century. We must maintain or increase our productivity in line with these needs, and we must accept the fact that thousands of acres of arable lands are lost each year to the needs of airports, roads, industry and urbanization.

COL Reno, I want to go on record as being a proponent of the Belle Fountain Project, and I am an enthusiastic supporter of the U.S. Corps of Engineers (and especially the Memphis District). However, I must tell you in all sincerity that during the past several years, the emergence of the final recommended plan reveals somewhat of a departure from the original planning. I feel that your office will want to know of any local divergent opinions and thoughts that might have an effect on the final completion of this most ambitious plan which I believe is scheduled for the year 1994. Of course, that is the purpose of this public meeting.

I respectfully submit for your attention, the following points of view --

Item # 1 --
Historically, this project was originally planned under a "gentlemen's agreement" between N.E. Arkansas and S.E. Missouri back in the early sixties. The scenario went something like this,-- "Missouri says if you people in Arkansas will help us work for the Belle Fountain Drainage Project in S.E. Missouri, we will help you get the large pumping station down at Marianna, Arkansas, which you need to pump all of our water over the levee into the Mississippi river.... So we won't have to run

the risk of penetrating our levees with drainage structures along the river." The scenario and plan looked like a winner, and sure enough -- in May, 1977, Arkansas wound up with the Huxtable Pumping Station at Marianna, which the Corps took great pride in proclaiming this to be the largest fresh-water pumping station in the world. Since that time, there seems to be a slippage, or loss of memory by our good neighbors to the South on the part of this "gentlemen's agreement". I see in the recommended plan, that a 5,000 feet section of the State-Line road is to be filled to a depth of 2 to 5 feet so that Missouri water will not be allowed to over-flow toward the No. 9 community in Arkansas. Needless to say, this was always the historic path of normal drainage. I do not object to this addition in the plan because the Corps will undoubtedly provide proper drainage back to the North into the main-line ditch leading to the Belle Fountain. However, this addition will cost a great deal of money, as every farmer knows that the natural drainage in our country is generally North to South, and it is not very cost-effective to make water "run up-hill". Although the plan states this new built-up area, or dam was accomplished through mutual agreement with Missouri, I failed to locate a written document in the plan certifying to this agreement.

Testimony given by Arkansas farmers and landowners at a Drainage District meeting with the Corps at Blytheville last year revealed increasing resentment and hostility toward the idea of moving Missouri water through the State Line and into the Big Lake area. Information was also given at that meeting that large acreages of low-lying areas have been cleared and placed into production since the Belle Fountain project was originally planned. The comment was made that every time you improve an area of drainage up North, you are likely to get resistance and complaints from someone down South, where the water has to eventually flow. I certainly don't quarrel with these farmers down below, because I sympathize with them in their losses due to floods and inadequate drainage. I am merely pointing out that we should all be working together to solve our mutual drainage problems, because the Corps is faced with the problem of trying to satisfy the needs of all of us, and within somewhat restrictive budgetary constraints.

Many farmers had serious losses in Pemiscot County in July, 1976 due to a heavy flood which prevented their re-planting their crops at that late date. These farmers traced the problem to a large degree to the apparent

illegal filling of spill-way areas along the East line of the Big Lake Wildlife Refuge, by the Arkansas Game and Fish Commission. This matter was later litigated in the Arkansas Claims Court last year at Little Rock, and although no money was appropriated or granted to satisfy the claims of Missouri farmers, the hearing did accomplish some measure of good for all farmers in both Arkansas and Missouri. Testimony at the hearing revealed that the Arkansas Game and Fish Commission was not particularly fond of having any agricultural surface water from any source that might interfere with their purpose of providing a habitat for fish and wild-life. Their representative stated flatly -- that they only wanted "ankle-deep" water for the ducks -- not knee-deep water, not hip-deep water, or anything flowing into the refuge over and above their specific needs. Much to the credit of the Corps of Engineers, the spill-ways which were blocked by the Game and Fish Commission have been degraded since the 1976 flood, and all interested observers in Mississippi County, Arkansas, and here in Pemiscot County should be on the alert for any possible future attempts to impede our flow of agricultural water. It appears to be an engineering fact, that virtually all of the surface water from this area, must flow through Arkansas, for final deposit in the Mississippi river, at the Marianna pumping station. The Corps has examined many other options and suggestions from local interests, such as the location of gravity flow structures, or pumping stations in Pemiscot County. I believe that in each study, they have determined, that this would not be economically feasible. Therefore, it behooves the interests of Arkansas and Missouri, together with the Corps of Engineers to work together toward a solution of our common drainage problems. I am confident that we will accomplish these goals, and work together on the "same sheet of music", as our community leaders planned back in the sixties.

ITEM # 2 --

I view with alarm the change in the design of the project over the past several years, because of challenges from environmental and recreational groups. Their objections and demands for environmental impact statements have brought on expensive delays, and a tremendous drain on the available Corps resources. The fish weirs proposed in the plan will consume valuable farm acreage needed for the production of food, and the resulting monetary or recreational benefits to the public will be few indeed. The planned restrictive easments described under Paragraph G-03, Plate VI-2, concerning the prohibition of disturbing

the vegetation along the ditch banks and right-of-ways, to provide edge habitat for hunters and fishermen deserves some modification in my opinion. This paragraph states that these areas must not be mowed, cut, burned, chemically destroyed, or used as crop land. Inasmuch as Johnson Grass is declared a Noxious weed in the state of Missouri, and will likely grow in great proliferation, some provision must be made by the Corps to use a selective herbicide to control this troublesome vegetation. The state of Missouri provides strict sanctions against the growth of Johnson Grass, and railroads, utilities, drainage districts and farmers are well aware of this provision.

Although I have pointed out a few possible negative features of the Belle Fountain plan, I do not wish to ignore the positive improvements, modifications, and corrections that have been incorporated into the recommended plan by the Corps. I note with pleasure several new designs, by-passes, and deletions of grandiose extensions of the project, which would have caused an intolerable high budget cost, and would no doubt have been challenged by the Congress and the administration. In spite of the many barriers, obstacles, and bureaucratic snags placed in the path of the U.S. Corps of Engineers, they somehow still manage to run a "tight ship", and still maintain a high degree of respect.

I believe the Belle-Fountain project to be the greatest thing for Pemiscot County that has happened since the swamps were drained sometime around the turn of the century. I applaude the Corps in their efforts, and I say lets get on with the project.

CLYDE SOUTHERN
P O Box 116
Steele, Mo 63877
314-695-3075

Remarks to the Congressman Bill Emerson Advisory Council

SOUTHERN FARM CO., INC.
P. O. BOX 116
STEELE, MISSOURI 63877

TELEPHONES
314-695-3075
314-695-4868
314-695-3470

February 13, 1982

USDA 1982 WHEAT PROGRAM PROVISIONS:

COMMENT:

1. For the past 10 years, wheat, milo and soybeans have replaced cotton as the principal source of income for the Missouri Bootheel area.

2. Although Missouri as a whole has a reduced wheat acreage, the Delta counties in the Bootheel indicate a considerable increase in wheat acreage which was planted in October-November, 1981 prior to signing of the new farm bill.

3. Most of the total wheat crop investment has already been expended -- in fact the only significant expense remaining is a booster application of nitrogen and harvesting operations. Approximately 75% of the wheat crop will be double-cropped with soybeans. Although the anticipated profit is meager or non-existent based on current market projections, double-cropping is necessary to provide sufficient cash flow until the price structure improves.

4. It must be concluded that Bootheel and most Mid-South farmers are not likely to make significant acreage reduction in view of the incentives offered, and the announced objective of the Secretary of Agriculture to reduce the surplus will not be achieved. The local Pemiscot County ASCS director estimates that acreage reduction in the county will certainly be less than seven per-cent, and possibly less than five per-cent.

5. Although some livestock producers in other areas may derive advantage from hay cutting or grazing, this does not apply to the Delta area, which is primarily row-crop intensive.

6. The new farm bill appears to favor states which produce tobacco, sugar, peanuts and dairy products. Those states in the Spring Wheat area also have an advantage as they still have an option not to plant wheat this Spring, whereas Delta growers have already planted, and made considerable investment prior to the announcement.

7. A news clipping from the DELTA FARM PRESS (Mississippi), provides an in-depth analysis of wheat set-aside problems for the Mid-South, and is enclosed.

RECOMMENDATION:

Growers of Soft Red Winter Wheat who planted during the months of October-November (normal planting dates) and who had a stand prior to the signing of the farm bill in December should not be penalized or discriminated against for their early planning and investment. These growers should be eligible for price support loans, target price protection, and be allowed to participate in the Reserve where storage payments of 26½ cents per bushel are available. They should not be required to destroy wheat planted prior to the signing of the new farm bill.

Remarks to the Mississippi River Commission:
High-water inspection trip, Caruthersville, Missouri
May 17, 1982

General Read, members of the Corps of Engineers, distinguished guests, ladies and gentlemen. I am Clyde Southern, Chairman of the Board of Commissioners of the Pemiscot County Port Authority. General Read, I appreciate the invitation to join you today and for the opportunity to make a statement concerning our efforts to develop a new river port in Pemiscot County.

For once we come before you not extending our hand and asking for a favor. As you're aware, our project was a Section 107 navigation project and our harbor was dredged in late 1980 and early 1981. Since then, we have leased six of our seven flood free acres at the port to Hutson Company, Inc., who will construct a bulk fertilizer import, storage and distribution facility. Just last week, they put out a new promotional brochure which has a fine two page spread on the port of Caruthersville. I brought along a copy to leave with you.

In these times of tight money and high interest rates we have not yet been successful in our efforts to obtain financing for further port development, primarily dredging to create additional flood free land and industrial sites to market. However, I want you to know how much the citizens of Pemiscot County appreciate the efforts on the part of your District Engineer in Memphis and you and your staff in getting this project through for us. It is the key to the economic development of this area and we will leave no stone unturned in seeking the necessary port development funds. We presently have three irons in the fire to obtain the necessary funding and hopefully, by the high-water inspection trip next year, we will have more good news to report. Rest assured that this valuable asset, our harbor, will not go to waste.

Thank you very much for your time, the opportunity to make this statement and the hospitality of the Mississippi River Commission. I have a copy of my statement which I will leave with your staff.

Remarks made to the Resources Conversation and Development Commission Annual Meeting at Dexter, Missouri in April, 1985

PEMISCOT COUNTY PORT AUTHORITY

HISTORY- Authorized in 1974 under Kit Bonds first administration. A series of plans and feasibility studies were conducted, and about five years ago, the Corps of Engineers dredged the harbor, removing sand from the river, and placing it between an old levee and the main-line levee.... At the same time, the County was using some of this area as a sanitary landfill, which allows flood free 100 year elevation. The port area consists of some 200 plus acres, of which 17 acres have been developed.

CURRENT- A private company, The Hutson Co of Paducah, built a private in bound bulk fertilizer terminal on 6 acres about two years ago, and quickly followed with a public out bound grain terminal on an adjoining 2 acres. There are nine additional acres available for private terminals, a public cargo dock, or new industry. The Port has been in operation only two years, but in the first year put through 259,000 tons (172 barges), and the second year (1984), increased this by 38% to 327,000 tons (219 barges). There are three 20,000 bushel grain storage tanks, two 10,000 ton dry fertilizer domes, and a liquid fertilizer tank. Although port development is slow and tedious, wse have done well in comparision to other river ports. In our second year of operation, due to our large tonnage, we became the second largest public port in the state of Missouri-- and this includes Kansas City. During this same period, we also paved the road up to the site, and current plans call for erecting a 100,000 gallon water

storage tank for fire protection and other facilities at the site.

FUTURE PLANS- We hope to add a general cargo dock within this next year. This will require a considerable outlay for a wharf, a warehouse, and a crane to handle heavy cargo. Ultimately, we hope to handle containers for use on regular river barges, and the Lash/Seabee smaller type barges. I was pleased to see the Governor state in his budget message to the Legislature, that he was for additional funding of economic development, and for international marketing. He also announced that he would move forward on the issuance of the remaining $400 million in Amendment One capital improvement bonds... We watch this with eagerness..and for the past two years, we have been frustated on a very illusive plan to ship edible grains (mostly no-hilum type soybeans) by container direct to overseas customers. type grain (mostly no-hilum type soybeans) by container direct to overseas customers. We know there is a very large profitable market, and we have more seed-cleaning plants within a 35 miles radius of the port, than probably any other area of the world. We have conducted a research through the USDA, Foreign Agriculture Service, and we know the market is out there. We are still working with the American Soybean Association, as well as government agencies both State and Federal, and we have not given up on this plan by any means -- however, it does become somewhat frustating, when we are unable to locate a precedent for this type operation, and realize that our international expertise is very limited.

NEEDS - We agree that locals should not ask for help, when they can help themselves. It was amazing to see the speed with which our port started fertilizer and grain operations. Observers such as the Corps of Engineers, and prominent officials on the SS Mississippi in a recent low-water inspection visit said, "How in the world could you get a port constructed and in operations this quickly"?? The answer simply is PRIVATE ENTERPRISE WILL PERSEVERE AND SUCCEED WHEN A PROFIT INCENTIVE IS OUT THERE..

HOWEVER -- We find there are some things that locals cannot do, and one of them is International Marketing! We must have assistance from both State and Federal government, to get a foot hold on the markets of the world. It is a cruel competitive world out there, and as we all know, the five big grain cartels, have had control for a long, long time, and they are still in control.... We are continually criticised for the quality of grain we are shipping to overseas customers. We here in the Bootheel (N.E. Arkansas and West Tennessee) have the ability to grow and ship quality grains, and compete with any other area of the world. With economic river transportation, proper seed cleaning, and handling, we can more than compete, but somehow, we need a foot in the door, and we cannot do it alone. The Administration, together with participating states must budget some money for Export Trading Companies, or some other type entity which will can wheel and deal on an international basis. The Administration must use some of the money it saves on reducing

past expensive programs, and apply these resources to the PL 480 program, the Export Credit Guarantee program, and possibly the expansion of Most Favored Nation category. I believe that all of this will happen during the next year or two, and that the Pemiscot County Port Authority, will be grow to be very, very large by the turn of the century.....

Clyde Sanders
Chairman

Remarks made to the Pemiscot County Farm Bureau Annual Meeting at Hayti, Missouri on August 22, 1985

PEMISCOT COUNTY FARM BUREAU
P. O. BOX 80
CARUTHERSVILLE, MO 63830

RESOLUTIONS 1985/1986

AGRICULTURAL CREDIT

FARM CREDIT SYSTEM-- We oppose current efforts to blend or consolidate funds of the Production Credit and Federal Land Bank associations into one central nation wide bank. We do not oppose plans of Production Credit Associations and the Federal Land Banks to merge administrative and office locations to accommodate a more modern and efficient system such as that planned by the Sixth District in St. Louis.

Present plans to centralize the system should be abandoned, and local boards should continue their present management of resources. At the time of full re-payment to the Federal government more than 20 years ago, an emergency fund was established at Federal level to allay the needs that are being manifested at this time. The system should level with the Congress as to their true financial standing, and if necessary ask for an additional loan to maintain stability until economic conditions improve.

LAND DEBT RESTRUCTURING PLAN-- Historically, farmers have managed to keep a "close-hold" on the financing of their land and production costs. However, due to Federal actions such as embargoes, budget deficits, and defective monetary/fiscal policies causing high interest rates, the farmer has been victimized by actions not of his own fault. Therefore, it becomes necessary that a privately financed, land debt restructuring plan be promulgated with the assistance of the Federal government. The International market, and the general public should be allowed to to invest in farm lands, and enjoy the benefits of long term appreciation, guaranteed income, and tax advantages. Variations of this plan call for a government farm mortgage association very similar to current popular real estate ventures such as "Ginnie-Maes, or Fannie-Maes, which enjoy the implied financial backing of the Federal government. An "Aggie Mae" plan could result in livable interest rates to the stressed farmer, and would not be a budget buster to the Federal Treasury.

TRANSPORTATION

USER FEES - INLAND WATERWAYS-- Sixty to 80 percent of soybeans and grain exported will move through inland waterways to export facilities. Currant proposed legislation by the Congress to increase user fees by fual tax increases is ill-timed for a depressed agriculture and river shipping industry. We urge that user fees now available in the Inland Waterways Trust Fund be put to use in the construction of facilities, such as Lock & Dam 26, and others which are needed to restore

efficiency to the river system. Inland operation and maintenance of the waterways should remain a Federal responsibility. We oppose any increase in the bargeline fuel tax over 10 cents, and we oppose ton-mile, cargo fees, or local cost sharing formulas.

CARGO PREFERENCE-- The existing preference law is a maritime subsidy which penalizes agricultural exports. It requires that 50% of all U.S. government financed cargo be carried by U.S. flag vessels, resulting in exorbitant charges to the Federal government up to three times world cargo rates. This unfair law is blatantly anti-agriculture and should be repealed immediately. If the law is needed to help preserve our diminishing merchant fleet for national security reasons, stop the cargo preference system and make a direct subsidy to the merchant fleet. Anyway you cut it, the present law is a subsidy, and the farmer should not be penalized.

FARM POLICY

UNITED STATES GOVERNMENT--

Subsidization of Foreign Competitors

National policy over the past several years has under-mined U.S. export efforts and competitiveness in the world market arena. We urge the President and the Congress to restore vitality to U.S. agriculture by enacting or repealing current policy which allows subsidization of foreign competitors at the expense of the American farmer. We oppose loans and grants which allow other countries to expand their production and export of commodities which are in world surplus.

The Department of State, Agency for International Development (AID), budgets Technical Service Grants to foreign countries at $2.1 billion, whereas the U.S. farmer is budgeted slightly more than $1 billion. Aid to our foreign competitors at twice the rate of assistance to the American farmer is an un-conscienable act, and illustrates the continued effort by urban liberals to "shoot ourselves in the foot".

Changes needed in National Policy

A. We favor a Presidential Line Item Veto to prevent budget busting pork barrel amendments, which are tacked on to critical legislation.

B. We favor an International Free Market philosophy, with farmers having freedom to plant any crop (not including illegal drugs) which has profit potential. Set asides or conservation acreage should be limited to that under current "sod-buster" legislation. Realizing that agriculture cannot survive during the next five years under current economic projections, the Nation must ask its consumers to accept a slightly higher food cost policy which is now in effect in other parts of the world. A safety net must be in place through the U.S. Department of Agriculture, to provide a financial "cushion or transition" to the overall International Free Market Concept.

C. Farmers are being discriminated against under present self employed Social Security taxes. In times of low net income, this confiscatory tax has become more burdensome than the income tax. We believe the self-employed should be allowed to deduct one half of FICA costs in line with current charges of one half to the employee, and one half to the employer.

STATE GOVERNMENT

A. We oppose existing laws which prohibit the corporate ownership of farm lands, other than family held corporations. Foreign investments have proven to be very small in contrast to the hysteria created that foreign owners would dominate our agricultural sector. Missouri has suffered from a lack of operating capital in agriculture and we should not inhibit the flow of International Capital in the market place. We should repeal this law, and allow foreign ownership of land.

B. We urge the Missouri State Legislature utilize Third State Building Funds (Amendment No. 1) to re-allocate grants un-used by December 31, 1986 to the State Department of Agriculture for specific use in support of International Agricultural Marketing through our Inland Waterways.

C. The University of Missouri, Delta Center, at Portageville, should be allowed increased funding, due to the unique nature of agricultural production in the Missouri Bootheel. Twenty five percent of Missouri's total crops are produced in this area, and a dis-proportionate share of the University budget is presently allocated to this facility.

CLYDE SOUTHERN
Chairman, Resolutions

Remarks to the Missouri Senate Interim Committee at the National Guard Armory in Dexter, Missouri on October 29, 1985

SENATE INTERIM COMMITTEE ON STATE FARM POLICY

I.

My name is Clyde Southern, and I live at Steele in Pemiscot County. The first portion of my testimony will reflect resolutions recently approved and forwarded by the Pemiscot County Farm Bureau.....

CORPORATE OWNERSHIP OF MISSOURI FARM LAND

Current state law prohibits corporate ownership of farm lands, other than family held corporations. Some judicial sources question the constitutionality of this law. It is estimated that only three tenths of one percent of corporate held farms are owned outside family ownership. Foreign ownership is extremely insignificant, and there has been no reason for mis-placed hysteria that foreign governments would some day dominate our agricultural sector. The current loss of farm values is a serious factor in the declining value of lending portfolios in our farm lending institutions. Recently an official with a large insurance company which has purchased extensive acreage in other states made the statement that "We would be bidding on acreages of 3,000 and above in the state of Missouri today,if this law was not in effect". The current law should be repealed, and the price of land should be established in the free enterprise market place where it belongs.

UNIVERSITY OF MISSOURI, DELTA CENTER

The University of Missouri, Delta Center, at Portageville, should be allowed increased funding, due to the unique nature of agricultural production in the Missouri Bootheel. Twenty five percent of Missouri's total crops are produced in this area on less than 10% of the state acreage. A dis-proportionate share of the University budget is presently allocated to this facility.

II.

The following remarks reflect the views of the Pemiscot County Port Authority, in Caruthersville, of which I am a member.

INTERNATIONAL MARKETS

Sixty to 80 percent of the soybeans and grain exported move through inland waterways to export facilities. The Missouri farmer is severely handicapped in marketing his grain direct to overseas consumers. We have learned that a tremendous market exists world wide for clean, wholesome edible grains. Unfortunately, most of our produce is blended and contaminated at export points, until the average farmer would not recognize the grain he produced, when it arrives at its destination. For the past several years we have been on an illusive mission of attempting to market clean, edible type soybeans via container barge direct to overseas customers. There are probably more seed cleaning plants in a 30 mile radius of our port, than anywhere in the world. We know there is a continuous demand for specialty type soy beans for use in bean sprouts, tofu, bean curd, and natto. However, a great deal of International marketing expertise is needed to execute such a mission, and we do not have the facilities of an Export Trading Company, or

other marketing arms. In short, Pemiscot County is not quiet big enough for this job -- we will need State and Federal assistance.

During the past year, Third State Building Funds (Amendment No. 1) bonds have been allocated in the form of extensive grants for the purpose of Economic Development throughout the State. These projects are to be utilized prior to December 31, 1986, and it is likely that many of them will not be able to meet the criteria imposed. It is therefore proposed that any of these funds still unused by that date, should be re-allocated for the purpose of Economic Development on our Inland Waterways. Funding and responsibility should be given to the State Secretary of Agriculture for overall implementation of International Agricultural Marketing. This mission should also include the establishment of an Agricultural Marketing Data Base, for cooperative efforts with USDA, Foreign Marketing Service, and the various Commodity Groups throughout the world.

III.

The final portion of this testimony reflects solely the personal views of Clyde Southern -- farmer.....

FARM POLICY - FINANCIAL CRISIS -- STATE AND FEDERAL

This State Interim Committee can certainly have an effect on National Farm Policy, by reflecting their State philosophy to our two Senior Senators on Capitol Hill. This is an extremely important week in Washington as the Senate will likely "crank" out some type of farm policy within the next few days. The Congress may have come up with a "warmed over" version of the mistakes of the past decade, and there is a likelihood that it will face Presidential veto as it stands. The Senate has a chance to come up with a "dark horse" plan which might be accepted in a Senate-House conference, and one which might be accepted by the administration without veto.....

The biggest cash crop in the USA is soybeans, and most of the farmers in Missouri grow soybeans. The Senate has been briefed on a new one year plan proposed by the American Soybean Association, that will move our beans to market, and will be "budget neutral" in the face of high loan support prices which are facing USDA, CCC at this time. They propose the "Farm Acreage Income Restitution" plan.... (FAIR). This plan offers to lower the support price on soybeans from $5.02 per bushel down to $4.00 in exchange for a one time payment of $75.00 per acre on all soybean acreage on record at the ASCS office. Commodity analysts predict such a market oriented price would eliminate the "floor" from foreign growers, and discourage them from planting their soybean crops this Fall. The analysts further predict that such a lower planting would drive bean prices up to $6.50 per bushel next Summer. Of course, the greatest asset of the plan would be to provide an emergency transition payment to the soybean farmer so that he could make arrangements with his farm lender, and be allowed to continue in a survival mode. The staffs of Senator Eagleton and Senator Danforth are today seeking input from their constituency on this important farm bill. I strongly recommend this committee consider this "FAIR" plan and recommend its adoption in the U.S. Senate.

Remarks to the American Soybean Association Board of Directors in January, 1986

SOYBEAN PROPOSAL

We favor Federal legislation which will provide some degree of financial protection to the soybean producer during the critical transition necessary to reassert the previous U.S. trade share of world markets. The current loan rate of $4.56 per bushel is not commensurate with aid now being provided to other commodity growers, and will insure the demise of the second largest crop in the State of Missouri, causing economic devastation to agri-related suppliers.

We hold that income support be separated from price signals, and that soybean farmers be paid a pre-set amount of dollars per acre or per bushel, regardless of market prices. This TRANSITION payment should be phased out in five years with each successive payment being reduced by 20%. The amount of this payment should be equivalent to the amount currently budgeted for C.C.C. bean loans on the 86/87 crop (approximately 1 to 1 1/2 billion), divided by the projected national production of approximately 2 billion bushels. A fifty cent per bushel payment under this plan would provide a crutch for the financially stressed producer during the first year transition.

To accomplish a budget neutral stance with USDA, we favor abolishing the soybean loan rate in its entirety, thereby saving a considerable amount in operational funds and alleviating the current overload in ASCS offices. Funds would be targeted for needy farmers instead of payments to middle men merchants involved in C.C.C. storage and related activities.

SEE BACKGROUND PAPER

In order for this proposal to work, the Congress and Administration must insure that the following ground rules will apply: (1) No more embargoes (except War) (2) No subsidization of our competitors, such as that provided by the Department of State (Agency for International Development) (3) Maximum effort be made to compete with International trade predators by the use of export credit enhancements or similar programs. (4) USDA must not use soybean PIK during the early years of the transition, because dumping would tamper with normal markets (5) Transition payments should not be disallowed due to a per farm limitation.

BACKGROUND - SOYBEAN PROPOSAL

Historically, soybean producers have advocated a free market philosophy without asking for assistance or regulation. However, following several embargoes from the administration over a period of years, and subsidization from the Department of State and other Federal agencies, to our competitors in South America, an International Free Market no longer exists. We also have ongoing problems with the European Economic Community, which has been our No. 1 customer. It now becomes imperative that soybean producers have some type of financial assurance from the Federal government that will afford survival, lest they suffer the same consequences as the smoke stack industries.

The Food and Agricultural Policy Research Institute (Fapri), in their July, 1986 study, projects five years, showing effects of various loan rates, and other pertinent factors. When a comparison is made between the loan rates of $4.56, $5.02, and $6.00, it is seen that farm prices are projected higher as the loan is reduced. It must necessarily follow, that our South American competitors are doing rather well, living under the safety net of our loan supports, and would be most reluctant to continue increasing their acreages, if we failed to carry the umbrella. If there was no soybean loan support, fewer acres would be planted throughout the world, including the USA. Many erodible and marginal acreages would go into Conservation Reserve, transition payments would ease the pain, and encourage some acreage to return to hay and pasture.

QUESTIONNAIRE FOR FEDERAL AGRICULTURAL MORTGAGE CORPORATION NOMINEES

Enclosure # 2, Farm Credit System Loan Activity

Gordon Clyde Southern, Personal Account

Federal Land Bank Association, Caruthersville, Mo.
Long term farm mortgages

DATE	AMOUNT	STATUS
9-24-85	$637,997.75	Paid in full to secure a better interest rate at a Commercial Bank.

Production Credit Association, Caruthersville, MO.
Production and Equipment Loans

DATE	AMOUNT	STATUS
1983	$30,000	Paid
1984	44,500	Paid
1985	30,000	Paid
1986	30,000	Paid
1987	25.000	Paid
1988	55.170	Current

SOUTHERN FARM CO. INC.

Federal Land Bank Association, Caruthersville, MO.
Long Term Farm Mortgage

DATE	AMOUNT	STATUS
1980	$96,000	Current
Current Balance	71,548	

Production Credit Association, Caruthersville, MO.

DATE	AMOUNT	STATUS
1983	$210,900	Paid
1984	215,500	Paid
1985	185,000	Paid
1986	193,200	Paid
1987	267,600	Paid
1988	188,819	Current

QUESTIONS SUBMITTED BY SENATOR HARKIN FOR ALL FARMER MAC NOMINEES.

GORDON CLYDE SOUTHERN - RESPONSE

1. What role do you envision for the Farmer Mac system in revitalizing the economics of rural areas?

Farmer Mac has the role of providing long term fixed interest rates to farmers and ranchers. This will allow borrowers to plan a cash flow operation over long periods of time as practiced successfully by other commercial operations under the free enterprise system. If this facility had been available during the early and middle 80's, agri-related business firms such as implement dealers, farm suppliers, fertilizer dealers, cotton gins, and lending institutions would have had a better chance of survival. The rural housing feature of Farmer Mac allowing long term loans on homes built in small communities is a unique concept never available before. Fannie Maes, Ginnie Maes, and Freddie Macs have supplied this advantage to urban home buyers for many years. Better access to capital markets will be afforded under Farmer Mac.

2. Do you believe that Farmer Mac should develop specific policies designed to help communities and areas of the country that have special problems of inadequate capital and credit or weak economies?

Small farmers and family farm operations should be encouraged by special provisions from the Board. Special problems of inadequate capital and weak economies in certain areas should be addressed and be given consideration, based on how the bottom line condition of the mortgage pool might be effected.

3. What should the Farmer Mac board do to address the problems cited in the previous question?

Upon certification of a mortgage pooler, special consideration should be given to the specific geographic and economic area involved to see if a solution could be found when this problem occurs. Farmer Mac could help strengthen the economy in rural areas by allowing rural lenders to service more loans.

4. Do you foresee problems of Farmer Mac backed loans going predominantly to an exclusive set of only the very best loan prospects?

No. It is the duty and responsibility of the Farmer Mac board to see that wide distribution of the loan portfolio should insure that the loans do not indicate that lenders are "skimming off the cream" which occurred in past years during years of financial stress in agriculture. Standards must be made flexible to permit eligible borrowers be given proper consideration.

5. What special policies, if any, should the Farmer Mac board implement to ensure that the benefits of the Farmer Mac system are made available to the broadest possible range of borrowers and financial institutions in terms of financial situation and geographic location?

Make sure that Class A and B stock is widely distributed in modest stock offerings which will provide an entry level readily available to small financial institutions. Each stock holder will then have a vote in electing board members which will properly reflect and maintain the grass roots constituency.

6. Do you believe that the Farm Credit Administration has the particular financial expertise necessary adequately to protect the public's interest in its regulation of Farmer Mac. (FCA approved Farmer Mac Regulations at its 9/6 board meeting.)

Probably -- However, I may not be in a position to provide expert judgment on this matter at this time. I believe the law does provide for proper oversight supervision of Farmer Mac.

7. Given the federal guarantee backing Farmer Mac, how can the Farmer Mac board help to protect the public interest from unforeseen circumstances, such as another drought? Will Farmer Mac be capable of dealing with a crisis?

A. The Farmer Mac board must exercise proper regulatory authority to see that mortgage poolers are properly certified and competent to handle mortgage loans and securities.

B. Proper supervision and accounting will insure that the legally required 10% of mortgage principal be retained outside the Farmer Mac guarantee and that proper appraisals must be conducted to assure good sound equities in all loans.

C. Select qualified certified pooling and marketing facilities which service loans from a wide geographic area covering many different crops, and agricultural resources. In the event of drought or other natural disaster, this would insure that no one crop or area could cause serious loan losses to that particular mortgage pool. Example: Southeast Missouri, Northeast Arkansas, and Western Tennessee have the best crop prospects for soybeans and grain sorghum this year than at any time in the past ten years. Outside this area (75 to 100 miles) a very serious disaster has occurred due to drought. A pooling facility at Memphis or St. Louis servicing an area of 2 or more States would therefore have a mixed portfolio of loans (good crops and bad crops), which would provide for a sound mortgage pool.

D. I believe the 15 permanent board members of Farmer Mac represent a broad cross section of agricultural constituency. They will provide professional and competent regulatory judgment that may not be found in any other financial institution.

Jason Clyde Souther

QUESTIONS FROM SENATOR DASCHLE FOR GORDON CLYDE SOUTHERN.

1. How as member of the board will you make certain that smaller banks are active participants in the Secondary Market? Do you feel it is the role of Farmer Mac to provide community outreach?

The board has the responsibility to design stock offerings affording wide distribution to all financial institutions, to include special emphasis on smaller banks. Stock offerings should provide an entry level easily accessible to all institutions. Each stock holder will then have a vote in electing board members which will properly reflect and maintain a grass roots constituency.

Farmer Mac does have community outreach responsibility, which can be provided by close and long term cooperation with trade associations representing Class A and B stockholders.

2. You have been nominated as a "public" member of the board. Do you see the role as a public member as being any different from that of other board members?

All board members, elected and public should have the same vote and authority on the board. However, the appointed members have a unique responsibility in that they represent all stockholders and borrowers, whereas elected members may be oriented toward supporting their own constituency.

3. Should underwriting standards reflect the issue of borrowers rights? In your view, how should this be addressed?

There should be no discrimination against states which have borrower's rights. However, the law does require that Farm Credit System institutions must notify patrons they have a right to refuse a pooling arrangement if they choose.

4. In your view what benefits will the Secondary Market provide to farmers and ranchers?

Secondary mortgage markets will attract investment capital from all sectors to include pension funds, mutual funds, and individual investors. This will permit long term reasonable fixed interest rates to farmers and ranchers so they may plan their cash flow over longer periods of time. Cyclical economic and weather related calamities can be leveled out, and give a better chance of survival over short term disasters. If Farmer Mac had been available during the early and middle 80s, this Nation would not have seen the tremendous failure rate in agriculture and banking during this hectic period. Farmer Mac will provide greater access to capital markets, which may not have been available in the past.

5. In your view should the Secondary Market benefit all farm real estate borrowers; those who may have difficulty getting credit, or just the most credit worthy borrowers?

In my view, Secondary Mortgages will be of benefit to all farm real estate borrowers. In past years, some banks and insurance companies pulled out of the mortgage market, and Farm Credit Systems were not prepared or capable of handling unprecedented demands. As a result, many family farms were lost due to marginal credit ratings and poor balance sheets. Short term loans with variable rates did not provide protection against unreasonable interest rates which sky-rocketed because of the dearth of farm financing available at the time. For those borrowers having extreme difficulty obtaining credit (last resort) a secondary market under Farmers Home Administration under Subtitle B is available.

Jordon Clyde Souther

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August 8, 1988

The Honorable Patrick Leahy
Chairman
Committee on Agriculture
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On June 23, 1988, President Reagan announced the names of the five individuals he planned to nominate to be members of the Board of Directors of the Federal Agricultural Mortgage Corporation. We are advised that the Senate Committee on Agriculture, Nutrition and Forestry has tentatively scheduled confirmation hearings on August 11.

One of those nominated by the President, Gordon Clyde Southern, is a Missouri cotton and grain farmer and is widely respected and supported by all who know him in that region. In our judgment, Mr. Southern would be a capable and effective Board member. Our organization is in favor of his appointment and we hope you will also support Mr. Southern's nomination.

Sincerely,

Earl W. Sears

Earl W. Sears
Executive Vice President

EWS/jlc

cc: Members - Committee on Agriculture

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OFFICE OF THE PRESIDENT

July 11, 1988

The Honorable Patrick Leahy, Chairman
Senate Agriculture, Nutrition, and Forestry Committee
The United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The National Cattlemen's Association urges you to move expeditiously in your confirmation hearings of the recent Presidential appointments to the Federal Agricultural Mortgage Corporation. You and the Members of your Committee worked diligently to craft the 1987 Agricultural Credit Act to help farmers and ranchers. The "Farmer Mac" was a key cornerstone of this comprehensive legislation.

We want to work with you and the members of the Senate Agriculture Committee to ensure that no delay occurs between the interim and permanent board. A delay would not be in the best interest of farmers and ranchers.

We appreciate your attention.

Sincerely,

Dale Humphrey

Dale Humphrey
President

DH/vc

cc: Democratic Members of the Senate Agriculture, Nutrition and Forestry Committee